REPORT OF INVESTIGATION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
OFFICE OF INSPECTOR GENERAL

Case No. OIG-526

Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme

Appendix, Volume IV

March 31, 2010

EXHIBIT 95

Tomorrow's Commission meeting starts at 10:15 a.m. CST

11/4/2003 6:37:26 PM

From: [redacted]
To: Cohen, Jeffrey A. [redacted]@sec.gov]

Suprema is #16 (but like #6 on the Regular Calendar, after the 10 items or so on the Summary Calendar). I'm meeting with [redacted] and [redacted] at 10:00 a.m. on a matter forwarded to us by Spence, Stanford Financial (offshore CDs sold to Mexican investors, but with a Houston connection). It may or may not become a MUI.

EXHIBIT 96

(b)(5), (b)(7)a

11/5

Mtg w/ (b)(6), (b)(7)c (b)(6), (b)(7)c (b)(6), (b)(7)c

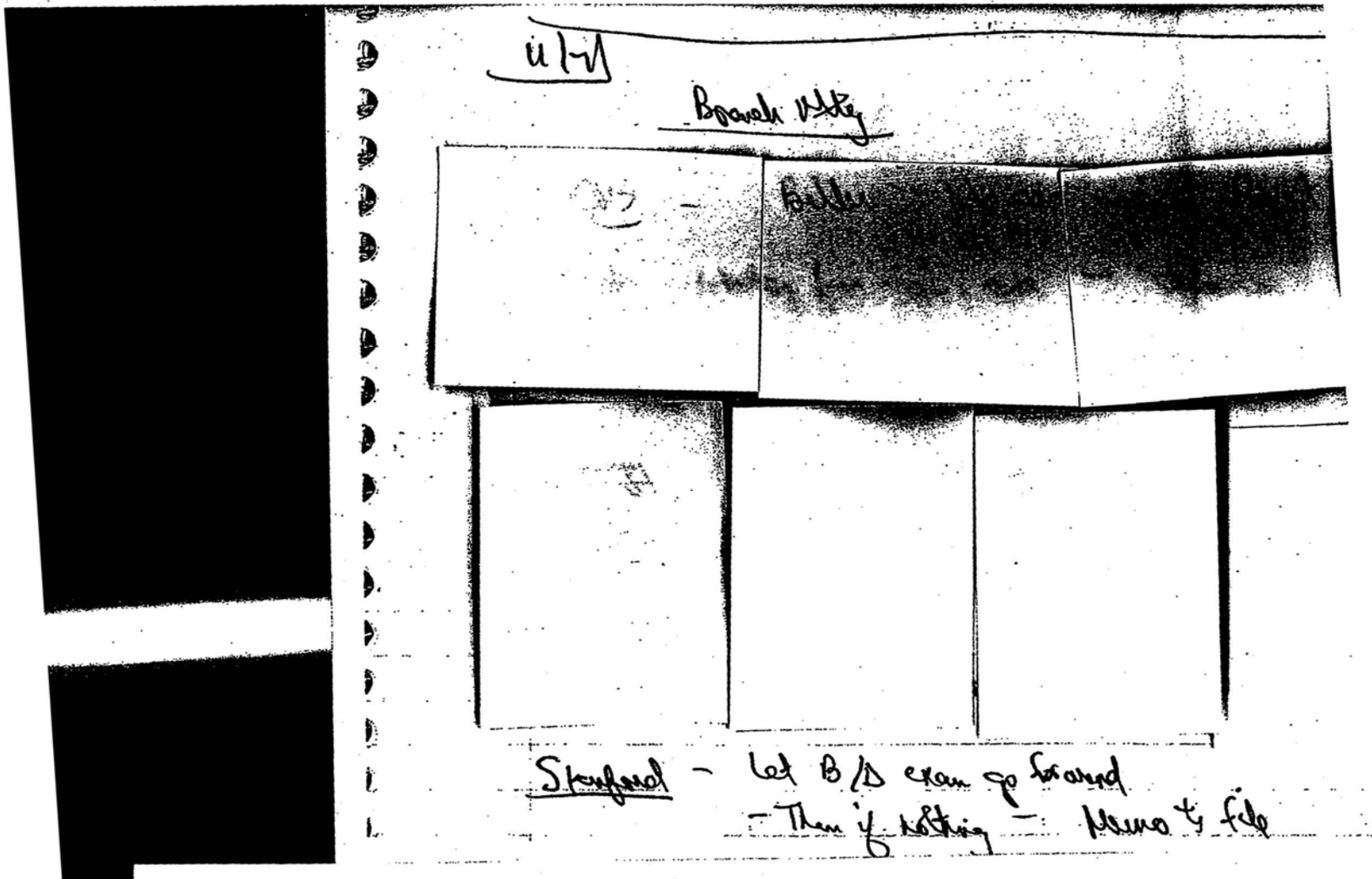
re: Stanford Financial Group

Stanford Fin'l Bank, Bank of Antigua

Cannot hot things - for Bear Stearns

CMS, TIME, Sunshine

(b)(5), (b)(7)a



Stanford - Let B/S exam go forward
- Then if nothing - Memo to file

EXHIBIT 97

RE: Antigua

10/27/2004 5:21:52 PM

From: Prescott, Victoria F.
To: [redacted]@SEC.GOV]
Cc: Preuitt, Julie A. [redacted]@SEC.GOV]; [redacted]@SEC.GOV]; [redacted]@SEC.GOV]

I would like to have the information by the end of next week. I don't know as that it needs to be as formal as a legal opinion, but I would like to be able to rely upon it in my evaluation of whether a court would likely rule that [redacted]

Perhaps to start with, general information is the way to go. From there, we can determine whether it would be useful to become more formal. If it would be useful for me to speak directly with this person, feel free to give them my number.

Thanks very much for your help, [redacted]

Victoria
[redacted]

-----Original Message-----
From: [redacted]
Sent: Wednesday, October 27, 2004 3:48 PM
To: Prescott, Victoria F.
Cc: Preuitt, Julie A.; [redacted]
Subject: RE: Antigua

Hi Victoria,

The person who I was hoping had information about Antigua does not, in fact, know the information that you're seeking. I don't think [redacted] Let me consult with someone at the Treasury Dept. to see if they have any thoughts about this. Are you looking for a legal opinion, or just general information? How soon do you need it?

Thanks,
[redacted]

-----Original Message-----
From: Prescott, Victoria F.
Sent: Tuesday, October 26, 2004 2:58 PM
To: [redacted]
Cc: Preuitt, Julie A.; [redacted]
Subject: RE: Antigua

Hi [redacted]

Just wondering whether the Antigua expert has returned. [redacted]

[redacted]

(b)(5), (b)(7)a [redacted]

Please let me know who can opine on this issue.

Thanks,

Victoria
(b)(6), (b)(7)c [redacted]

-----Original Message-----
From: Prescott, Victoria F.
Sent: Monday, October 18, 2004 6:17 PM
To: (b)(6), (b)(7)c [redacted]
Subject: Re: Antigua

Thanks for the quick reply. I think we can wait til Monday. Any chance you could give a general sense of things in the meantime?

My general impression is (having VAST international experience....) that while not as bad as some offshore jurisdictions, no cd would be particularly secure or anywhere comparable to being FDIC insured.

Also, the bank in question is Stanford, which seems to be more like an offshore investment company rather than a lending and depositing institution.

Victoria

-----Original Message-----
From: (b)(6), (b)(7)c [redacted] @SEC.GOV>
To: Prescott, Victoria F. (b)(6), (b)(7)c [redacted] @SEC.GOV>
Sent: Mon Oct 18 18:53:33 2004
Subject: RE: Antigua

HI Victoria -- The person who knows most about this is out of the country all week, although I can probably contact him before Monday. How soon do you need the information?

Thanks,
(b)(6), (b)(7)c [redacted]

From: Prescott, Victoria F.
Sent: Monday, October 18, 2004 4:58 PM
To: (b)(6), (b)(7)c [redacted]
Subject: Antigua

(b)(6), (b)(7)c [redacted]

I am reviewing some certificates of deposit issued by a bank in Antigua, and would like to know the general state of

banking regulations there. (b)(5), (b)(7)a

(b)(5), (b)(7)a

Do you have any insights on this issue, or can you direct me to someone who does?\

Thanks,

Victoria Prescott

(b)(6), (b)(7)c

EXHIBIT 98

BROKER/DEALER EXAMINATION RECAP SHEET

STANFORD GROUP COMPANY
5050 Westheimer 3rd Floor
Houston, Tx. 77056

Exam#: BD2005FWDO001 **Type of exam:** Surveillance

SEC#: 8-48611 **Investment Adviser:** Yes
CRD#:39285 **Investment Co.:** No

Net Capital: $8,055,816
Exc/Def: $7,805,816
As of: 8/31/04

Gross revenues YTD:
CD Referral Fees $26,927,982
Commissions $10,356,916

Branches:
OSJ: 4
Franchise: 0

Employees:
Registered: 130
Non-Registered: 51

Trans/Mo.: 3,500 **Active Accounts:** 12,700

Persons/entities controlling firm: Stanford Group Holdings, Inc.
Privacy Act Notice furnished to: (b)(6), (b)(7)c

Disposition of Examination: Enforcement Referral, Deficiency Letter
Significant Issues/Findings: Yes

EXAMINATION STAFF AND SUPERVISION

Field Work Start: 10/04/04
Field Work End: 10/08/04
Report Comp. Date: 12/2/04

Mgmt. Review Date: 5/26/05
Mgmt. Approval Date: 9/13/05

Signature

Examiner: (b)(6), (b)(7)c _____

Examiner: (b)(6), (b)(7)c _____

Br. Chief: (b)(6), (b)(7)c _____

ADA Reg: Julie A. Preuitt _____

Broker Dealer Examination Report
BD2005FWDO001

Stanford Group Company
5050 Westheimer
Houston, Texas 77056

I. EXECUTIVE SUMMARY

Examination Type: Surveillance
Firm SEC #: 8-48611
Firm CRD#: 39285

Examination Findings:

SEC Rule 10b-5	Firm made material misstatements and failed to disclose material facts in their sales of unregistered securities.
NASD Rule 2310	Firm recommended transactions which were not suitable.
Rules 10b-10, 17a-3(a)(8) NASD Rule 2230	Firm failed to disclose to its customers its compensation for securities transactions. It also failed to prepare or obtain confirmations for all transactions.
SEC Rule 17a-4(b)(1)	Firm failed to maintain copies of confirmations for all transactions.
NASD Rule 3010(b)(1)	Firm failed to establish, maintain and enforce written supervisory procedures.
NASD Rule 3010(c)	Firm failed to conduct a periodic review of customer account activity.
NASD Rule 3011	Firm failed to develop and implement an adequate written anti-money laundering program.

Items of Concern

Section 5, 1933 Act	The firm may have been engaged in an unregistered distribution of securities.
Rule 15c3-1	The NASD may have approved an invalid subordinated loan.

Disposition: Enforcement Referral, Deficiency Letter

II. DESCRIPTION & HISTORY OF REGISTRANT

Stanford Group Company ("SGC") has been registered with the Commission since October 25, 1995. The firm is wholly owned by Stanford Group Holdings, Inc., which in turn is owned by Robert Allen Stanford ("Mr. Stanford"). Mr. Stanford directly and indirectly owns or partly owns a number of companies including Stanford Trust Company ("STC") which offers trust services to investors; Stanford International Bank ("SIB"), a private bank offering deposit accounts and Certificates of Deposit to investors; Bank of Antigua, a commercial bank; and Stanford Development Corporation, a real estate acquisition, development, and management company.[1] Jay Comeaux is the firm's President, Albert Rincohn its CFO, and Lena Stinson its COO. Jane Bates is the firm's Chief Compliance Officer.

SGC operates pursuant to the (k)(2)(ii) exemption to 15C3-3, and clears all transactions on a fully disclosed basis through Bear Stearns and Company ("Bear Stearns"). The firm also has a clearing agreement with First Southwest Company which it utilizes only to clear transactions effected by its fixed income trading desk for firm proprietary accounts. The firm calculates net capital pursuant to the alternative standard and has a minimum net capital requirement of $250,000 because it routinely receives customer checks made payable to itself. As of August 31, 2004, the Staff calculated the firm's net capital to be $8,055,816 and its requirement to be $250,000, giving the firm excess net capital of $7,805,816.

SGC employs approximately 130 registered representatives ("RR") and 51 non-registered persons. The firm currently has 11 registered branch offices. The firm has approximately 12,700 active customer accounts, including 11,430 retail and 270 institutional. SGC effects approximately 3,500 transactions per month. For the eight months ended August 31, 2004, the firm generated gross revenues of $41,427,666. SGC's income was comprised of commissions from the sale of SIB issued securities (65%), equity commissions (25%), and other sources (10%).

III. EXAMINATION PURPOSE & SCOPE

(b)(6), (b)(7)c and (b)(6), (b)(7)c initiated a surveillance examination of SGC in October 2004. The firm was selected for examination based primarily on our findings in our 1997 examination of the firm in which we cited the firm for possible misrepresentations, misapplication of customer funds, and related books and records violations in connection with the firm's sales of the Certificates of Deposit ("CDs") issued by its affiliate, SIB. Our prior examination findings, combined with the facts that the firm had increased its revenues by almost 400% (to $44 million) since our previous examination and that sales of the SIB CDs accounted for over 70% of the firm's revenues, increased our concerns that the firm may be continuing to violate federal securities laws in their sales of the products. Specifically, the focus of the examination was to obtain information regarding the CDs in order to determine if they are securities, the manner in which they were sold to customers, and the disclosure information provided to customers. If our examination determined that the CDs were securities and that the firm's activities constituted a securities distribution, we also planned to determine whether there was an exemption from registration available to the firm. The Staff also reviewed the firm's Anti-Money Laundering

[1] Information regarding other companies affiliated with SGC are contained in the examination exhibits.

("AML") procedures and the implementation of those procedures as the firm's client base includes a large percentage of foreign individuals and corporations.

The Staff's examination focused on the firm's financials and sales practices. Our review included, but was not limited to the firm's: general ledger, trial balance, balance sheet, income statement, and net capital computation (August 2004); bank account statements; written supervisory procedures ("WSP"); AML procedures and AML training documents; customer account statements, account information forms, and customer identification documents; due diligence information, purchase applications, and subscription documents; transaction blotters; advertising and correspondence files; customer complaints; supervision of branch offices; and continuing education documents.

IV. Risk Assessment

As part of our pre-examination work, the Staff reviewed the Commission's computerized records, CRD records, and other information pertaining to SGC. In 1997, the FWDO Staff cited SGC in a deficiency letter for possible misrepresentations, misapplication of customer funds, and related books and records violations in connection with sales of SIB issued securities. Since the firm is engaged in the same activities we believe SGC to be a high regulatory risk with regard to sales practice issues.

The Staff conducted a review of the firm's August 31, 2004 financial statements and net capital computation. The Staff's computation of the net capital confirmed that the firm had sufficient net capital to meet regulatory requirements. Based on our pre-examination reviews as well as our current examination findings, we determined the firm to be a low risk with regard to financial or net capital issues.

V. Examination Findings

The Staff believes that the SIB issued securities, which are marketed as certificates of deposit ("SIB CD" or "CD"), are CDs in name only and are claimed to be CDs as part of an overall scheme to evade federal regulation and to lull investors into believing that the safety of these securities is comparable to CDs issued by a United States bank. The Staff also suspects that ultimately little, if any, of the funds invested into the SIB CDs may actually be invested as represented to investors. This suspicion is fueled by SGC's apparent inability and SIB's refusal to provide requested documents regarding the CDs, including the actual uses of the monies raised. Since SIB is located in Antigua, and the securities in question are not registered, we have been unable to require SIB to provide or to otherwise gather the necessary documents to either verify or allay those suspicions.

Although it may be difficult to prove that the offering itself is fraudulent, SGC has nonetheless committed numerous securities law violations which can be proved without determining the actual uses of the invested funds. Violations include making misrepresentations and omissions to customers, charging excessive commissions, and failing to disclose the amount of commissions charged. SGC also violated several other SEC and SRO Rules regarding books and records, supervision and anti-money laundering.

Background

SGC claims that SIB CDs are not securities. In keeping with that claim, SGC purports that it does not actually "sell" the CDs, but only refers potential investors to SIB. Furthermore, SGC does not refer to its receipt of transaction-based compensation for its sales of CDs as commissions, but rather as "referral fees". And, although SGC locates investors, collects their funds and forwards those funds to SIB, SGC claims that those investors are not their customers, but rather are customers of SIB. The staff initially found SGC's claims confusing, but ultimately realized that no matter what terms the firm was using it did not change the essence of the transactions being reviewed: SGC is a registered broker-dealer receiving transaction based compensation for the sale of securities, and is therefore fully subject to the federal securities laws.

SGC's primary business activity is centered on marketing SIB CDs. SGC typically hires RRs who are already well-established and then encourages the RRs to sell the SIB CDs to their existing customers. SGC does not make cold calls to expressly offer the SIB CDs, but instead makes cold calls for the opening of new brokerage accounts and, upon establishment of an account, encourages customers to purchase the product. Based on a sample of emails sent to its customers, SGC appears to market the securities as a high-yielding safe alternative to investing in the markets or in U.S. bank CDs.

SGC markets to both foreign and U.S. customers; however, approximately 90% of its sales are to Latin Americans. Nearly 70% of SGC's $44 million 2004 revenues were from commissions for selling the product. SGC is not the only entity which sells the CDs. Approximately one-third of SIB CDs are sold by SGC. The remaining sales are made by SIB itself and foreign affiliates of SIB. U.S. citizens currently hold $227 million out of $1.5 billion in SIB CDs.

SGC sells all three types of SIB CDs: the FixedCD, the FlexCD, and the Index-Linked CD. Each has a $50,000 minimum investment.

- The FixedCD has a term from three to sixty months, and the initial interest rate may increase if interest rates go up during the designated term. If interest rates fall during the term, customers are guaranteed the original rate until maturity. No withdrawals are allowed during its term.
- The FlexCD has the same features as the FixedCD, but additional purchases of $2,500 or more may be added at any time during its term.[2] Investors may withdraw up to 25% of the principal amount plus accrued interest with five days prior notice (with a maximum of four withdrawals per year allowed).
- The Index-Linked CD is sold with terms of three, four or five years only. It yields the greater of a minimum "guaranteed" interest rate or a rate linked to the performance of a specified equity market index. No withdrawals are allowed during the first year.[3]

[2] Additional investments earn interest at the initial interest rate.
[3] After the first year, withdrawals are allowed, but are subject to penalties.

Superficially, the SIB CDs are very similar to a conventional certificate of deposit. They are issued by what appears to be a bank, have minimum investment amounts, and have guarantees on either fixed or minimum interest rates; however, upon closer inspection, it becomes apparent that they are not CDs at all and, if the funds are invested as SIB claims, are securities subject to federal regulation.

SIB is Not a Bank

Conventional certificates of deposit are not considered securities and are not subject to the SEC's purview because banks and other similar institutions that issue them are subject to stringent regulatory oversight within the U.S. Part of that stringent regulatory oversight includes ensuring that banking institutions are not engaged in activities that would subject their customer deposits to risk. Under federal law, there are strict limitations as to the types and risk level of securities in which banking institutions may invest customer funds and also limitations on the risk levels of the types of loans that can be made with those funds. Federal law also requires that banks establish reserves to ensure that banking institutions will be able to meet obligations to customers, including both interest and principal payments on CDs. And, in case regulatory oversight fails, deposits are insured (subject to some limitations) by the Federal Deposit Insurance Corporation ("FDIC"). In foreign countries that have similar stringent banking regulations, U.S. Courts have held that certificates of deposit issued by banking institutions in those countries are also not securities.[4] The staff doubts that Antiguan banking laws offer the same protection to customers offered within the U.S. Whether or not there is a similar regulatory structure within Antigua, it does not appear to be applied to SIB because SIB claims to invest the majority of its customers' deposits into investment vehicles that are subject to significant risk and loss including equities, corporate debt, precious metals, and foreign currencies. Furthermore, SIB has not established any significant reserves to cover any potential losses. Approximately a five per cent loss in its portfolio of investments would eliminate all liquid reserves. And, finally, deposits into the bank are not insured by FDIC or any similar depository insurance program.[5]

SIB does not seem to have a legitimate reason to be chartered as or referred to as a bank as it does not even engage in most traditional banking activities such as making commercial loans or offering checking accounts. SIB performs few other functions besides simply taking investor deposits and investing those deposits. Other than calling itself a bank, the Staff could find little else that would suggest that SIB is a banking institution.

Use and Risk of Funds Deposited With SIB

Per SIB's 2003 annual report, SIB pools the proceeds from its CDs and invests those funds into an international portfolio of bonds (42%), equities (39%), cash and fiduciary[6] (11%),

[4] For example, *Wolfe v Banco Nacional de Mexico*, 739 F.2d 1458 (1984).
[5] SIB notes that it does have several types of insurance. Any deposits it holds in U.S. banks have FDIC coverage. SIB also carries a bankers' blanket bond and a liability policy for the benefit of its directors and officers.
[6] It is unclear as to what "fiduciary" means in this context.

and precious metals (8%). In other SIB marketing materials and disclosure documents, SIB also claims to engage in arbitrage activities and to use leverage as it deems appropriate.[7]

Obviously, unlike a traditional certificate of deposit, SIB CDs are subject to risk. In fact, an SIB disclosure document makes the statements that "the ability of SIB to repay principal and interest on the CD Deposits is dependent on our ability to successfully operate by continuing to make consistently profitable investment decisions" and "You may lose your entire investment (principal and interest)....."

The Staff could discern no legitimate reason to refer to these investments as CDs. Instead, they appear to be referred to as CDs to lull investors into believing that the product offers the safety of a conventional certificate of deposit and to circumvent U.S. federal securities laws requiring registration.

SIB CDs are not registered

SIB has not registered the CDs although they appear to be an investment contract. In a disclosure statement to customers, SIB defends its decision not to register the CDs with the following simple claims: "The CD deposits are ordinary deposit obligations of SIB. We believe that the CD deposits and the CD certificates are not securities as such term is defined under U.S. federal and state securities laws." As discussed above, SIB's claim lacks merit. SIB is a bank in name only and thus any securities it issues and sells to U.S. investors are subject to federal securities laws including registration requirements unless the securities qualify for an exemption. It may be possible that the securities qualify for an exemption under Regulation D Rule 506. SIB, despite its claim that its CDs are not subject to registration requirements, has filed for just such an exemption from registration. Rule 506 prohibits a general solicitation and places a limitation upon the number of unaccredited investors. It appears that SIB and SGC have complied with those two requirements – at least in terms of U.S. investors. In terms of foreign investors, SIB and SGC do not make an effort to determine if investors are accredited or non-accredited. It is unclear as to whether or not the offering is still in compliance with Regulation D Rule 506 under this circumstance.[8]

It could also be argued that SIB should be registered as an investment company. It pools investor's funds and invests those funds into other securities. SIB does not appear to comply with any of the exemptions from registration as an investment company. It has more than 100 investors and it does not verify that its customers are qualified investors (defined has having at least $2.5 million in assets). And, according to its own disclosure documents, SIB fails to meet

[7] A March 2003 SIB newsletter, which contained information concerning SIB's arbitrage activities, indicated that they were the "hallmark" of what differentiated SIB's investment strategy from others. The newsletter indicated that SIB's arbitrage activities included fixed income convertible arbitrage, futures/derivatives arbitrage, event arbitrage, and long/short equity strategies.

[8] It is possible that under these circumstances that the U.S. portion qualifies for an exemption from registration under Regulation D while the foreign portion of the offering qualifies for an exemption under Regulation S. Regulation S has its own unique set of circumstances in that it does not apply to sales to foreign investors if the sale occurs within the United States. Making a determination of where these sales occurred seemed impractical on an examination basis.

the definition of, and therefore the exemption for, a foreign bank per the Investment Company Act of 1940.[9]

SIB CDs appear to be a fraud

Regardless of whether SIB CDs are eligible for exemption from registration, the securities are subject to the anti-fraud provisions of the federal securities laws and the securities being offered have the earmarks of a fraud: SIB pays excessive commissions; it sponsors aggressive sales contests at SGC; it promises returns too high to be legitimate; it claims to have made significant returns in each of the last ten years, no matter how poorly the international markets have performed; and perhaps most importantly, it refuses to provide details as to its investment portfolio not only currently, but for any point in history. Finally, Allen Stanford enjoys not only significant wealth, but also appears to enjoy special privileges from the Antiguan government, which he may use to mask a fraudulent scheme.

- Excessive Commissions[10]: For every CD sold, SGC receives a three percent recurring annual trailing commission, paid pro-rata on a quarterly basis, based on the amount invested for as long as the customer holds the CD.[11] Since many CDs are sold with a five-year term, the three percent annual trailing commission is equivalent to 15% of a customer's investment. Then, if the CD is renewed, the trailing commission continue.[12] Not only do these commission payments violate NASD Rules (as further discussed below), they are indicative of fraudulent activity. Historically, high commission rates are often associated with fraudulent activity as they may be offered as an incentive to RRs to push a perhaps otherwise unsavory product. The practice of paying a high commission rate on an indefinite, on-going basis further provides the RRs with an incentive to keep investors from withdrawing their funds, another hallmark of questionable activity. Finally, high commission rates suggest that a significant portion of investor funds are used to pay the commission because it would be difficult to legitimately pay such a high commission rate out of earnings – especially in this case where the issuer claims to be investing the funds based on "time-proven conservative criteria".

- Aggressive Sales Contests: Prizes offered include trips to Antigua and expensive automobiles.[13]

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[9] Under Rule 270.3a-6(b)(1) foreign banks are excepted from the definition of an investment company if they are engaged substantially in commercial banking activity and are not operated for purposes of evading the Act.

[10] The payment made for sales of the CDs as described by SIB appears to be a trailing concession; however, since we do not believe we can rely on SIB's disclosures, and for purposes of this report, the difference between commissions and concessions is strictly semantic, all payments for sales of the CDs will be referred to generically as commissions.

[11] SGC makes a spurious claim that they do not "sell" the CDs but refer customers to SIB and that SIB pays SGC "referral fees" rather than commissions.

[12] The commission rate is in excess of NASD limits. Offerings made pursuant to Regulation D Rule 506 are limited to paying an upfront commission of a maximum of 12% in upfront and in continuing compensation. See NASD Rule 2810. Mutual funds are limited to a maximum of 8.5% in upfront and continuing compensation. See NASD Rule 2830.

[13] Conversely, one RR stated that she was fired for refusing to sell SIB CDs.

- High "Interest" Rates: In keeping with the appearance that the SIB CDs are similar to conventional certificates of deposit, SIB refers to its distributions to investors as "interest" payments as opposed to a return on investment or a dividend. The "interest" payments are far in excess of what a conservative, low-risk investment would return. SIB paid average "interest" rates of 9.63% in 2000, 9.13% in 2001, and 7.17% in 2002. This is even more incredible when one considers that SIB paid another 3% in commissions. In regard to its Index-Linked CD the "interest" rates paid are even more incredible. October 2004 sales literature indicated that the Index-Linked CD had a five-year annualized return ranging from ***9.25% to 47.34%***. SIB paid these rates based on a formula that pays the greater of 3.5% or a percentage of the S&P 500 return. The percentage of the return of the S&P 500 is at SIB's discretion, but one of its marketing materials stated that an example of the return paid would be ***125%*** of the return of the S&P 500. The Staff is unaware of any legitimate short-term investment that not only guarantees a return significantly higher than a CD, but allows you to participate up to 125% of equity market returns.

- High Returns Every Year: SIB claims that it has consistently been profitable every year over the last ten years. For example, from 2000 through 2002, SIB reported earnings on investments between approximately 12.4% and 13.3%.[14] This return seems remarkable when you consider that during this same time period, SIB supposedly invested at least 40% of its customers' assets into the global equity market. Ten of twelve global equity market indices were down *substantially* during the same time period. The indices we reviewed were down by an average of 11.05% in 2000, 15.22% in 2001 and 25.87% in 2002. It is unlikely that the portion of the portfolio invested into debt instruments (approximately 60%) could make up the expected losses in the equity portion of the portfolio. For example, in 2002, when the global indices were down 25%, the debt portion of the portfolio would have to generate an approximate 35% to 40% return for SIB to generate the 12.4% overall return it claimed.

- SIB will not Disclose Its Portfolio: Most troubling of all, SIB refuses to disclose any of its specific uses of customer funds. SIB first claimed (through SGC) that Antiguan banking secrecy laws prohibited the disclosure of such information. The Staff suggested that Antiguan secrecy laws probably applied to keeping secret the identities of bank account holders rather than the use of investor proceeds. At that point in time SIB changed its claim, indicating it's refusal was a matter of keeping Chinese Walls between itself and its affiliate, SGC. Chinese Walls are generally perceived by the Commission as a barrier between investment bankers and research analysts, both of which may have inside information, from trading activity at a firm. This situation does not appear to merit the need for Chinese Walls. Furthermore, even if it did, it would not preclude SIB from disclosing the details of its use of investor proceeds from earlier time periods. Based on the totality of the situation, the Staff believes that SIB will not disclose its underlying investments because the funds cannot possibly be invested as SIB claims.

[14] This extrapolation is based upon two premises. First, that the year end revenues were generated from returns on SIB's portfolio, and that customer deposits were the exclusive source funding the portfolio. Second, that customer deposits remained constant throughout the year.

- Allen Stanford: Allen Stanford is a very wealthy man. He owns significant real estate holdings on Antigua and has both loaned and/or given significant sums of money to the Antiguan government. In exchange it appears that he has been granted special privileges. For example, Allen Stanford has his own terminal/gate at the Antiguan Capital's airport and is allowed to fly in and out of the country without going through customs. This situation raises the obvious concern that Allen Stanford may be participating in money laundering. It also raises concerns that he is allowed to use investor funds without any oversight and that some of those investor funds are being used to support his real estate holdings.

Without the underlying records it may be impossible to determine whether or not the offering is a fraud. Regardless, whether it can be proved that the offering is a fraud, SGC is violating many SEC and NASD Rules in their sales of SIB CDs.

VI. VIOLATIONS AND DEFICIENCIES

A. Misrepresentations and Omissions – Rule 10b-5

The Staff's review found that SGC may have made material misstatements to investors concerning the SIB CDs, as well as failing to disclose material facts in connection with the sales. The type of disclosures provided to investors purchasing SIB CDs is dependant upon whether the investor is a U.S. citizen or a foreign national. U.S. citizens receive far more disclosure than foreign investors.

a. U.S. Investors

The disclosure materials SGC provides to investors are a confusing mosaic regarding the risk of the investment. Prospective U.S. investors are given a short, user-friendly sales brochure that makes the offering seem similar to a CD and clearly guarantees investors a minimum interest rate or return. Along with the sales brochure, U.S. investors are also given a separate small type-face, 20-page disclosure document entitled "Disclosure Statement U.S. Accredited Investor Certificate of Deposit Program" ("Disclosure Statement"). The Disclosure Statement provides a hodge-podge of conflicting information. It identifies the issued security as a certificate of deposit issued by a chartered bank of Antigua and Barbuda. The Disclosure Statement goes on to say that "At maturity of the CD Deposit, we will provide you the principal amount in the CD Deposit plus any accrued and unpaid interest." Another section of the Disclosure Statement is entitled "Guaranteed Rate of Return". These statements imply a safety of principal and the guarantee of receipt of interest on the principal. In stark contrast, on other pages, the Disclosure Statement explains that the funds will be used to invest in bonds and securities (which are subject to volatility) and declares that there are significant risks: "....the ability of SIB to repay principal and interest on the CD Deposits is dependent on our ability to successfully operate by continuing to make consistently profitable investment decisions", and "You may lose your entire investment (principal and interest) under circumstances where we may be financially unable to repay these amounts."

In light of the confusing written information investors are given, the Staff suspects that investors are forced to rely on statements made by SGC's RRs to make their investment decisions. We reviewed a sample of emails to determine what types of statements were being made to investors and noted several which clearly undermined any sense of risk associated with the CDs. For example:

> "Income is your primary concern (our last conversation). Consider This: A fixed CD for 5yers-rate 7.4% for amts between 500m-999,999....Their (sic) are numerous terms for varying amts and maturities....This is at The Stanford International bank....It is a decent interest rate with peace of mind.(no volatility)."
>
> And,
>
> "Considering the not very bright prospects of the market and the high cost of maintaining this account I would like you to cancel the account and transfer the cash back to our deposit in order to be invested in the safe and stable CDs."[15]

b. Foreign Investors

In marked contrast to the risk disclosures made to U.S. investors, foreign investors receive only assurances of the safety and security of the product. SGC does not send to its foreign customers the Disclosure Statement described above, but only a marketing brochure which repeatedly compares the SIB CDs to conventional U.S. certificates of deposit, thereby implying safety and security. One illustration compares the growth of a $1,000,000 investment in a SIB CD for ten years to the growth of a U.S. bank CD. Another compares interest rates on SIB CDs versus U.S. bank CDs over a ten-year period along with the notation that "Over the past decade, Stanford International Bank CDs have outperformed U.S. bank CDs by an average of 4.6%." Specific statements regarding the lack of risk are contained throughout the document. In a listing of the advantages of the product, the first item is "Depositor security" described as "Our investment philosophy is anchored in time-proven conservative criteria, promoting stability in our certificate of deposit products. Our prudent approach and methodology translate into deposit security for our customers." "Key Benefits" include multiple references to the "guarantee" of minimum interest rates. The marketing brochure does note, however, that the funds are invested into "a portfolio of highly marketable securities", but even this indirect allusion to risk is downplayed by statements which claim that such a strategy is in the best interest of SIB investors because it results in "No Credit Risk" (because it is not making commercial or unsecured loans) and in "No Loan Losses" (for the same reason).

B. Making Unsuitable Recommendations – NASD Rule 2310

The NASD requires that in recommending to a customer the purchase of any security, the member firm shall have reasonable grounds for believing that the recommendation is suitable as to the customer's financial situation and needs. Since SGC and its representatives do not have

[15] On a practical basis, it was impossible to determine if the recipients of the emails were U.S. or foreign investors, but we do not have any reason to believe that RRs make different claims to their U.S. investors than to their foreign customers.

the information available to determine the actual investments made with the investors' funds and the risk level of the SIB CDs, it cannot know if the product is suitable as to its customer's needs. Furthermore, not only is there no specific information available, the information that is available is highly suggestive of a fraudulent offering which would be inherently unsuitable for any investor.

C. Failure to prepare or obtain confirmations for SIB CD transactions - NASD Rule 2230, SEC Rule 10b-10, SEC Rule 17a-3(a)(8), and SEC Rule 17a-4(b)(1)

The firm failed to prepare, obtain or maintain confirmations of SIB CD transactions effected through the firm. The firm does not independently prepare confirmations of the transactions, but rather relies on SIB to send confirmations to investors. Without copies of confirmations it is unclear if investors receive any notice regarding the commissions paid to SGC for sales of the CDs. On page nine of the Disclosure Statement given to U.S. investors a section entitled "Referral Fees" states that SIB has entered into a referral agreement with SGC and refers the reader to a section entitled "Affiliate Transactions" for further detail. Under the Affiliate Transactions section, the fourth paragraph states that "The fees paid pursuant to the referral fee agreement with SGC are a percentage of SGC's managed client portfolio of SIB deposits, and are currently up to three percent, negotiated annually."[16] It is not clear that the three per cent referral fee is paid as long as the funds are on deposit, nor is it clear how SIB is funding the fees. As for sales to foreign investors, there is no discussion regarding commissions in any of the materials SGC distributes to those investors.

SGC also failed to disclose to its customers any information regarding the compensation that registered representatives may earn in sales contests sponsored by SIB.

D. Charging excessive commissions – NASD Rule 2440, NASD Rule 2810, and NASD Rule 2830

SGC failed to abide by limitations imposed by the NASD regarding the amount of commissions that can be charged on any one transaction. As noted earlier, SGC receives three per cent annually on all investments made with SIB. In the case of SIB CDs with a 60-month maturity, the commission rate is equivalent to 15%. Since 15% is in excess of an allowable commission for any kind of securities, the commission on the 60-month CDs clearly violates NASD Rule 2440 regarding Fair Prices and Commissions. NASD Rules further define the maximum commission for several other securities including Direct Participation Programs ("DPP") (NASD Rule 2810) and Investment Companies (NASD Rule 2830). DPPs are limited to a maximum of 12% commission in upfront and ongoing commissions (trail fees, as in this case) and investment companies are limited to a maximum of 8.5%.

E. Failure to establish, maintain and enforce written supervisory procedures - NASD Rule 3010(b)(1)

[16] The verbiage certainly is odd. SGC does not manage a client portfolio. We assume, however, that it was written in this form because SGC and SIB are very careful to claim that SGC does not make any sales (which would suggest the CDs were a security as opposed to ordinary certificates of deposit), but only makes referrals.

The firm did not have any WSP designed to ensure that customer accounts purchasing SIB CDs were reviewed on a periodic basis and to ensure that transactions in the accounts of foreign investors were suitable.

F. Failure to conduct a periodic review of customer account activity in SIB CDs - NASD Rule 3010(c)

The firm failed to conduct a periodic review of customer activity in SIB CDs. The firm failed to conduct a periodic review of SIB CD activity in customer accounts because it maintains that the CDs are not securities and, therefore, it has no supervisory responsibilities regarding the products. In addition, given the records regarding SIB CD transactions currently maintained by the firm, the firm would be unable to conduct such reviews should it decide to do so.

G. Failure to develop and implement an adequate AML program - NASD Rule 3011

Inadequate AML procedures

- The firm's AML procedures require managing directors and administrative personnel in its branch offices to conduct reviews for possible money laundering. The procedures also require the firm's compliance department to review all money received and disbursed on a daily basis. The procedures for branch office reviews do not provide enough detail regarding how reviews will be conducted, the records to be utilized during the review process, and how reviews will be documented. The procedures for the firm's compliance department reviews are also not specific enough as to how reviews will be conducted, the records to be utilized during the review process, and how reviews will be documented. In addition, the firm has not specifically identified the individual responsible for conducting compliance department reviews.

- The firm's procedures failed to contain examples of money laundering "red flags" to be used by firm employees to detect possible money laundering. Such "red flag" information should be incorporated into the firm's procedures.

- The firm had no procedure discussing continued monitoring of customer accounts that it determines are engaged in "suspicious" activity.

- The firm had no procedure to ensure compliance with the Treasury Department's "Travel rule" when facilitating customer requests to wire funds from their customer accounts at Bear Stearns to their accounts or accounts of unrelated third parties. The Staff noted that the while the firm had no such procedures, it was providing the required information to Bear Stearns.

- The firm had no written procedures regarding obtaining information concerning the source of its customers' net worth and income and how a customer's account would be utilized (i.e. anticipated types of trading and trading patterns so that the firm would be able to detect future deviations from expected patterns). The Staff

noted that in practice, the firm obtains information regarding the source of its customers' net worth and income, but does not obtain and record information regarding the proposed use of the customers' accounts. None of the account information forms for 25 accounts reviewed by the Staff contained any information regarding the intended use of the accounts.

- The firm's procedures do not require firm personnel to obtain secondary documentary information to verify the identity of U.S. customers (either business entities or individuals). The Staff is unaware of any difference between documentation that should be obtained from non-U.S. customers versus U.S. customers.

- The firm failed to promptly update its AML procedures to designate its current AML officer, although that officer had been functioning in that capacity for approximately two months at the time of the Staff's examination. The firm's AML procedures designated Lea Stinson as its AML officer, when the officer was actually (b)(6), (b)(7)c .

- The firm had no procedure in place designed to ensure that there was no collusion between firm employees and customers with respect to money laundering.

- The firm's policies and procedures generally prohibit the receipt of currency, traveler's checks, and money orders for stock purchases or to be credited to customer accounts; however, the policies and procedures do not designate an individual to be responsible for determining whether cashiering department employees either intentionally or inadvertently receive such instruments. The procedures also do not discuss any reviews to detect the receipt of such instruments or how such reviews would be documented.

- The firm has no written procedure requiring the reporting of any financial interest in an account in a foreign financial institution. The firm's procedures do not address the use of Treasury Form 90-22.1 to report such financial interests and do not designate an individual as responsible for making the filings. The procedures also do not discuss how the firm will ensure that filings are made by the required filing date or what evidence the firm will maintain of the filings.

Failure to Adequately Implement AML Procedures

- The firm failed to implement written procedures that required it to categorize customer accounts based on degree of risk of money laundering. The firm's procedures required that all accounts be classified as Tier I, II, or III (I representing the lowest risk and III representing the highest risk) and that the frequency of account monitoring be commensurate with the account's risk level. The firm failed to categorize accounts as required by its procedures, and maintained no readily producible list of accounts by risk level. One of the account information forms utilized by the firm contained a section in which firm

personnel could indicate the account's risk level, but there was no evidence the section was being completed.

- While the firm's procedures require that firm personnel obtain primary documentary information from all customers opening accounts, the firm failed to implement its procedure in that it failed to obtain documents containing a photograph or similar safeguard for all of its U.S. customers. In addition, the firm did not obtain primary identification for any of its institutional accounts. Specifically, in two instances, the firm failed to obtain documentary information from individual U.S. customers. Such documentation is readily available in the form of driver's licenses. In nine other instances, the firm failed to obtain primary documentary information for business entities, such as articles of incorporation, partnership agreements, or business licenses. One of the nine accounts was a charitable organization which the firm's procedures identified as a Level II customer in terms of risk. One of the nine accounts had produced articles of incorporation, but the document was in Spanish and had not been translated into English.

- The firm's procedures required that it obtain secondary documentary information from non-U.S. individuals opening accounts; however, the firm failed to implement its procedures in this regard. Specifically, in three instances, the firm failed to obtain secondary documentation from non-U.S. customers. In another 13 instances, the firm failed to obtain secondary documentary information from U.S. customers, or non-U.S. business entities opening accounts. The Staff believes that based on the composition of the firm's clientele, it should obtain two forms of documentary identification from all customers.

H. Failure to file Treasury Form 90-22.1 - Bank Secrecy Act Section 103.24

SGC failed to provide documentation that it had reported financial accounts held at SIB during the 2003 calendar year within the time frames set forth in the Treasury's rules. Specifically, the firm was required to file Treasury Form 90-22.1 reflecting its financial interest in a SIB bank account and FlexCD by June 30, 2004. While the firm provided the Staff with a copy of the form and stated that the form had been filed as required by the rule, the firm did not maintain any documentation reflecting the date the form was filed and the form itself was undated. In addition, the firm was under the mistaken impression that it was not required to file the form for its 2004 holdings in 2005. The form is required to be filed by June 30th of the year following any year in which the firm has any interest in foreign financial accounts.

I. Failure to deliver the firm's privacy policy to all customers - Regulation S-P

The firm failed to produce evidence that it had delivered its privacy policy to all new customers upon opening accounts or effecting a securities transaction through the firm. Specifically, there was no evidence that six of 25 customer accounts reviewed by the Staff had received a copy of the firm's privacy policy upon opening their accounts. All of the customers were located in the firm's Miami branch office. The firm was only able to provide a document

containing a list of new accounts opened at the Miami office along with the initials of Miami branch office principals. The Staff noted that the document did not contain any specific evidence that the privacy policy had been delivered and that the principal's initials next to customer account numbers did not document delivery. Finally, the documentation provided by the firm as evidence that the privacy policy was delivered was not consistent with the evidence of delivery required to be maintained as discussed in the firm's WSP. The WSP require that a registered principal specifically note that the privacy policy was mailed by writing "PP" (for privacy policy), writing the date the policy was mailed, and initialing the line on the account information form entitled "Have you sent forms to customer?"

J. Failure to enforce WSP with regard to delivery of the firm's Privacy Policy to customers - NASD Rule 3010(b)(1)

The firm failed to enforce its WSP with respect to documenting the delivery of its privacy policy to new customers. The firm's WSP contained a requirement that a registered principal initial a line on the new account form indicating that the firm's privacy policy was mailed to the customer and include the date of the mailing. There was no evidence that principals in the firm's Miami office were following the procedure.

K. Failure to maintain accurate financial ledgers - SEC Rule 17a-3(a)(2)

The firm failed to record all liabilities to its general ledger. The firm maintains several Demand Deposit Accounts ("DDA") at Morgan Chase National bank. As of August 31, 2004, the firm was overdrawn on four accounts. The balances from these accounts were combined with other bank accounts at Morgan Chase instead of being properly recorded as liabilities. The amount of checks drawn in excess of bank balances per the records of a broker-dealer must be included in aggregate indebtedness, unless the broker-dealer carries two or more accounts at the same bank that are separated for the purposes immaterial to SEC Rule 15c3-3 and has an agreement with the bank stipulating that: except for bookkeeping and statement purposes, all such accounts are considered as one; the bank is authorized and agrees to treat these accounts as a single account and to apply balances in any one or more accounts to any debits in any other accounts without further advice or instruction by the firm; in the opinion of the bank's independent outside counsel, the agreement allows the bank to take the above action and is legally binding under banking, bankruptcy and other applicable federal and state laws.

L. Failure to meet continuing education requirements - NASD Conduct Rule 1120

The Staff reviewed SGC's continuing education plan for 2003 and found that eighteen covered registered persons failed to complete the firm's continuing education training program for that year.[17] All covered registered persons included in a member's plan must take all appropriate and reasonable steps to participate in continuing education programs as required by the firm.

[17] The term "covered registered person" shall apply to any registered person with a broker/dealer who has direct contact with customers in the conduct of the broker/dealer's securities sales, trading and investment banking activities, research analyst and immediate supervisors of such persons.

IX. ITEMS OF CONCERN:

SGC May be Offering Fraudulent Securities – Rule 10b-5

As discussed above, the Staff is concerned that the offering of the SIB CDs may in fact be a very large ponzi scheme, designed and marketed by SIB's and SGC's to lull investors into a false sense of security by their claims that the SIB products are similar to traditional U.S. bank CDs.

SGC May be Participating in a Distribution of Unregistered Securities – Section 5, SEC Act of 1933

As noted above, it is unclear as to whether or not the securities should be registered. If so, than SGC would be in violation of the above Act.

SGC's Subordinated Loan – Rule 15c3-1

The Staff is concerned that SGC's subordinated loan is invalid. On August 8, 2000, the NASD approved an equity subordinated loan between SGC and Stanford Financial Group Building, Inc. ("Stanford Building"). The loan amount was $4,000,000 with a maturity date of May 31, 2010. Stanford Building has never been a stockholder of SGC and therefore the loan should not have been approved as an equity subordinated loan. The proper classification of this loan would not place the firm in a net capital deficit.

X. EXIT INTERVIEW COMMENTS

On December 2, 2004 (b)(6), (b)(7)c and (b)(6), (b)(7)c discussed the deficiencies noted during our examination via a telephone conference call with SGC personnel. Jane Bates, (b)(6), (b)(7)c and (b)(6), (b)(7)c represented the firm during the call. During the exit interview, we discussed our concerns regarding the firm's sales of SIB CDs, WSP deficiencies, books and records deficiencies, AML deficiencies, Regulation S-P deficiencies, and deficiencies related to the firm's financial records.

XI. RECOMMENDED ACTION

The Staff will refer the Items of Concern, violations, and deficiencies discussed above to the FWDO Enforcement Division for their consideration and any appropriate action. Pending discussions with the Enforcement Staff, we will send a deficiency letter to the firm citing the violations and deficiencies noted in this report.

We will also request that the NASD explain why it approved the subordinated loan for SGC.

XII. SIGNIFICANT FINDINGS

A. Significant Findings – Yes. See below
B. Does the Exam Indicate Any Industry Trends – No.
C. Were any Novel, Unique or Emerging Issues Noted in the Exam - Yes. See below.

D. Potential New Rules to be Suggested as a Result of the Exam – No.
E. Any Issues/Findings That the Current Rules Were Inadequate to Address – No.

The broker-dealer is actively engaged in the distribution of an apparently fraudulent security offered by a foreign affiliate. The offering appears to be a Ponzi and/or a money laundering scheme, but because the affiliate making the offering is located in Antigua the Staff has been unable to gain access to the records which could either allay or prove our concerns. The broker-dealer, meanwhile, has violated several securities laws and rules including making misrepresentations and omissions, making unsuitable sales, failing to disclose its compensation, and charging excessive commission rates.

XIII. SUPERVISORY REVIEW & APPROVAL

Examiners: (b)(6), (b)(7)c

Reviewing Supervisor: (b)(6), (b)(7)c

Approving Official: Julie Preuitt

EXHIBIT 99

Stanford 12/15/2004 12:10:11 PM

From: Preuitt, Julie A.
To: (b)(6), (b)(7)c @SEC.GOV]; (b)(6), (b)(7)c @SEC.GOV]
Cc: (b)(6), (b)(7)c @SEC.GOV]; (b)(6), (b)(7)c @SEC.GOV]; Prescott, Victoria F. (b)(6), (b)(7)c @SEC.GOV]

(b)(6), (b)(7)c

I just spoke with Hugh. He is very concerned about Stanford and for good reason. I need a memo prepared which provides a brief summary regarding what we believe the problems are there and what documents they have not produced. When you get back in (b)(6), (b)(7)c why don□t the both of you come down and talk to me about Stanford. Also, did we ever contact the complaining RR?

Julie A. Preuitt

SEC - FWDO

Assistant District Administrator

BD Examinations

(b)(6), (b)(7)c

EXHIBIT 100

Re: Stanford 4/8/2005 5:44:00 PM

From: Preuitt, Julie A.
To: (b)(6), (b)(7)c @SEC.GOV]; (b)(6), (b)(7)c @SEC.GOV]

Don't believe so. Think he became an Antiguan citizen, but started out something other than US. Have to check with those smarter than me next week. Its probably on the web. Stanford is a very, very, very important person in Antigua.

From: (b)(6), (b)(7)c
Sent: Friday, April 08, 2005 4:44 PM
To: Preuitt, Julie A.
Subject: RE: stanford

I'm only speculating that some of the other agencies (FBI, DHS, State) may be able to get cooperation from the Antiguan authorities that we might not. Important question: does Robert Allen Stanford have residence, property, citizenship or other connections to U.S., aside from SGC?

From: Preuitt, Julie A.

Sent: Friday, April 08, 2005 4:41 PM

To: (b)(6), (b)(7)c

Subject: RE: stanford

Cool. I don't quite understand how they can go after bad guys in other countries, but in light of all the stuff that has happened since criminal authorities were looking pre 9/11 I bet they would be far more interested now!

From: (b)(6), (b)(7)c
Sent: Friday, April 08, 2005 4:38 PM
To: Preuitt, Julie A.
Subject: RE: stanford

It's OK. After we talk to Victoria, I can do some checking of my own. Key is probably to get one of the other agencies interested in the money laundering, drugs/terrorism aspect, and then ride their coat tails for the overseas action.

From: Preuitt, Julie A.

Sent: Friday, April 08, 2005 4:36 PM

To: (b)(6), (b)(7)c

Subject: RE: stanford

Victoria has tried to get info from OIA regarding Antigua. I don't think she got much info. Stanford Bank chides among other things the secretive banking laws in Antigua. I think the Justice Dept. was looking into this a few

years ago out of Miami. I believe they are quite limited in their actions because all the illegal activity, except the broker-dealer stuff, occurs over seas and the broker-dealer stuff isn't criminal. Sorry I don't have better detail.

From: (b)(6), (b)(7)c
Sent: Friday, April 08, 2005 4:32 PM
To: Preuitt, Julie A.; Prescott, Victoria F.
Cc: (b)(6), (b)(7)c
Subject: RE: stanford

Has anyone spoken to OIA about what our resources in Antigua? Even if they can't point us to any solutions, the FBI, State Department, and other agencies may be able to help. I just haven't looked into it.

From: Preuitt, Julie A.

Sent: Friday, April 08, 2005 4:28 PM

To: (b)(6), (b)(7)c; Prescott, Victoria F.

Cc: (b)(6), (b)(7)c

Subject: RE: stanford

Victoria will have difficult getting any time together next week before Friday. Right now a hearing is set on Thursday in Amarillo as a follow up to the temporary freeze granted today. Unless her schedule changes, lets look at Friday.

I agree. The memo is good. The problem is very interesting. We agree with many of your concerns. Its a difficult choice. It seems too difficult to go after the foreign entity so nothing happens or it seems too limiting to go after the US BD when we know the whole thing must be a fraud. As a result, we've just sat around for ten years fussing about what is going on at this firm/bank.

(b)(6), (b)(7)c and (b)(6), (b)(7)c did the examination. In case you didn't already know – they are awesome.

From: (b)(6), (b)(7)c
Sent: Friday, April 08, 2005 4:23 PM
To: Preuitt, Julie A.; Prescott, Victoria F.
Subject: RE: stanford

Victoria, this memo is terrific. Very nicely done.

Moreover, I agree with the preliminary legal conclusions in the memo, including the deduction that this almost certainly has to be fraudulent.

I would like to get together with both of you and talk in greater depth about possible courses of action. From a tactical standpoint, the international dimension concerns me because it limits our investigative powers. The BD is domestic, of course, but I'm concerned that taking action only against the domestic BD will have a limited long-term effect on the whole apparently-criminal organization, most of which is overseas. Moreover, the immediate impact on U.S. investors of an action against the domestic BD might not be favorable. Finally, I would want to coordinate anything we do with the FBI, because the likelihood that this organization is linked to terrorism, narcotics, or some other very bad conduct, strikes me as

likely.

Monday is the only day next week that is NOT good for me.

From: Preuitt, Julie A.

Sent: Tuesday, April 05, 2005 11:30 AM

To: (b)(6), (b)(7)c

Cc: Prescott, Victoria F.

Subject: FW: stanford

Victoria put this together. I think it does a great job of summarizing our concerns. It has been looked at by Hugh, but not by anybody in enforcement.

I don't think we can get the Bank (be clear when you read), but I do think that we can get the BD which will ultimately get the Bank. A LOT of money involved.

<< File: Stanford Memo to HMW2.doc >>

EXHIBIT 101

CONFIDENTIAL NON-PUBLIC
Attorney Work Product

TO: SPENCER BARASCH, ASSOCIATE DISTRICT ADMINISTRATOR
FROM: VICTORIA PRESCOTT, SENIOR SPECIAL COUNSEL
CC: HUGH WRIGHT, ASSOCIATE DISTRICT ADMINISTRATOR
JULIE PREUITT, ASSISTANT DISTRICT ADMINISTRATOR
DATE: 3/14/2005
RE: STANFORD GROUP COMPANY ("SGC")

An October 2004 examination of Commission-registered broker-dealer SGC, headquartered in Houston, Texas, has uncovered evidence suggesting that SGC and its affiliated company Stanford International Bank ("SIB") may be violating the securities laws. Specifically, we are concerned that:

- SGC is selling unregistered securities, possibly without a valid exemption;
- SGC and SIB are making misrepresentations and/or inadequate disclosures regarding the unregistered offering(s), most notably to foreign investors;
- SIB may be engaging in a fraudulent scheme (possibly either a money laundering and/or a ponzi scheme) through the sales of the unregistered securities, and refuses to provide the staff with sufficient information to dispel this concern.

SGC

SGC has approximately 110 registered representatives spread among its main office in Houston and 11 branch offices located throughout the U.S.[1] SGC's primary business is selling to its customers securities issued by its affiliate, SIB. Of SGC's $41,000,000 in revenue for the eight months ended August, 2004, approximately $26,000,000 (or nearly 63%) are from concession payments for the sale of its securities issued by SIB, which it markets as "certificates of deposit." It also appears that most of SGC's CD sales are to foreign investors. As of October 2004, SGC customers held approximately $1.5 billion of CDs. Approximately $227 million of these CDs were held by U.S. investors.

SGC (#8-48611) has been registered with the Commission since October 25, 1995. The firm is wholly owned by Stanford Group Holdings, Inc., which is owned by Robert Allen Stanford. The Stanford Financial Group website (www.stanfordfinancialgroup.com) also lists numerous affiliates, including:

- Stanford Trust Company Limited ("STC"), located in Antigua, which offers trust services to investors;
- SIB, located in St. John's, Antigua, West Indies, which holds itself out as offering private banking services to international investors, including CDs and credit cards;
- Bank of Antigua, Limited appears to be a full service commercial bank that offers checking/savings accounts, CDs, credit cards and both personal and commercial loans;
- Stanford Development Corporation, which invests in real estate limited partnerships and oversees the design and construction of, and manages, Stanford offices;

[1] SGC also has approximately 20 foreign associates located primarily in South and Central America.

- Stanford Development Company, Limited, which oversees the development of 60 acres surrounding Antigua's International Airport;
- Stanford Group Casa de Valores, S.A., a Ecuadorian broker-dealer with offices in Quito and Guayaquil; and
- Stanford Investment Advisory firms: Stanford Group Aruba N.V. in Aruba, Stanford Group (Suisse) AG in Zurich, Switzerland, Stanford Group (Antigua), Stanford Group Venezuela Asesores de Inversion, C.A. in Venezuela and Stanford Group Mexico, S.A. de C.V. in Mexico.

SIB[2]

SIB's disclosure documents state that its primary business is not to make loans, but rather to manage the deposits of its customers. SIB's annual financial statements suggest that virtually all customer deposits have been invested in its securities portfolios.[3] The Staff has made numerous efforts to obtain information about SIB through its examination of SGC. Despite the fact that SGC is generating as much as 63% of its revenue from the sale of securities issued by SIB, SGC claims that it keeps no records regarding the portfolios into which SIB places investor funds and that it can not get this information from SIB.[4] Indeed, SGC has related to the Staff that SIB claims it cannot divulge the specifics of how it has used customers' deposits, based (variously) upon the bank secrecy laws of Antigua and SIB's own internal "Chinese Wall" policies with SGC.[5]

The "CD" Offering

SIB offers three investments, each purporting to be a CD. The offering brochure for each of the CDs promises investors a guaranteed minimum interest rate or return, as noted below.

- Fixed CD: minimum deposit of $10,000. Interest rates range from 4.25% for a three month term to 7.025% for a 60 month term. Moreover, should rates decrease during the term of the CD, customers are "guaranteed the original interest rate until maturity."
- Flex CD: Minimum deposit of $50,0000. Interest rates range from 3.525 for a three month term to 6.525% for a 60 month term. Like the Fixed CD, "all clients are guaranteed the original interest rate until maturity." The Flex CD permits customers to make additional contributions of $2500 or more during the term of the CD which earn

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[2] SIB's activities have been under scrutiny by various regulatory agencies including the FBI and the OCC. A significant concern is whether SIB may be involved in a money laundering scheme. The Staff has been told that the OCC attempted to take action against SIB at one time, but that SIB sued the OCC and prevailed. However, the OCC was unable to confirm that this occurred.

[3] SIB's disclosure documents state none of the funds raised by SCG from investors are used to finance commercial or unsecured personal loans. Instead, SIB's investment portfolio consists of "foreign and U.S. investment grade bonds and securities, and Eurodollar and foreign currency deposits" and "securities from established, quality companies and governmental agencies from around the world."

[4] SGC also does not maintain a ledger account for each customer reflecting the SIB investment, as required by Rule 17a-3.

[5] SGC's admitted inability to get information from SIM about the investments underlying the CDs suggests that SGC may be violating NASD Rule 2310 (Suitability).

interest at the same rate as the original deposit. The Flex CD also permits up to four withdrawals annually of up to 25 percent of principal at any time, upon five days notice;

- Index-Linked CD: minimum deposit of $50,000. Permits the investor to choose the greater of either "guaranteed minimum annualized yield" of 3.58 % for a three year term; 3.65% for a four year term; and 3.71% for a five year term, or interest calculated based upon the increase of one of three indexes:
  - S&P 500—offering documents suggest a possible 125% increase
  - Nasdaq 100—offering documents suggest a possible 85% increase
  - DJ Stoxx 50—offering documents suggest a possible 100% increase

The CDs are Securities

SGC and SIB claim that they are offering and selling CDs, which they claim are not securities and that therefore, not governed by the federal securities laws. We believe that the offerings are CDs in name only, part of a scheme to evade securities registration requirements and to lull investors into believing that the safety of these securities is comparable to CDs issued by a United States bank.[6] In reality, the offerings are either an investment contract or interests in an unregistered investment company.

Section 5 of the Securities Act

The "CD" offerings are not registered. Based upon the SIB's Forms D filed with the Commission, it appears that SIB is relying upon Regulation D Rule 506 to exempt its CD offerings from registration. Rule 506 requires SIB to comply with the prohibitions against a general solicitation and the limitations upon unaccredited investors. The Staff has not found evidence of sales by SGC to non-accredited investors who are U.S. citizens. It does appear that SGC sold CDs to more than 35 unaccredited foreign investors. In fact, it appears that SCG made no attempt to limit sales to accredited foreign investors.

Moreover, as to these unaccredited foreign investors, SIB has not furnished the type of financial information required under Rule 506. Given the size of this offering, Rule 506 requires

[6] (b)(5), (b)(7)a

(b)(5), (b)(7)a

SIB to provide non accredited investors with the type of financial information as would be required in a registration statement. The scant financial information SIB provided to investors does not rise to this level—in fact, at the time of their investment, the only financial information provided to investors within the U.S. is a chart reflecting SIB's operating profits between 1990 and 2000. Foreign investors apparently received no financial information.[7]

However, in the event that the unaccredited foreign investors purchased their securities as part of a valid Regulation S offering, they would not be considered part of the Regulation D offering. Securities Act Release No. 33-6863 (April 24, 1990) states that "Regulation S provides generally that any offer or sale that occurs within the United States is subject to Section 5 of the Securities Act and any offer or sale that occurs outside the United States is not subject to Section 5."[8] Rule 903 of Regulation S states that an offer or sale is deemed outside the United States if it is made in an offshore transaction. Rule 902 of Regulation S states that an offer or sale is made in an offshore transaction if at the time the buy order is originated, the buyer is outside the United States, or the seller reasonably believes this to be the case. Further investigation is necessary to determine where the buyer was located at the time the buy order was initiated.[9]

Possible Unregistered Investment Company

Arguably, SIB should be registered as an investment company. Although banks are ordinarily excluded from the registration requirements of the Investment Company Act, SIB's own disclosure documents suggest that it fails to meet the definition of a foreign bank, and thus, is an investment company. Under Rule 270.3a-6 (b) (1) foreign banks are excepted from the definition of an investment company if they are engaged substantially in commercial banking activity and must not be operated for purposes of evading the Act. Rule 2a-6(2) defines engaged substantially in commercial banking activity as engaged regularly in, and deriving a substantial portion of its business from, extending commercial and other types of credit and accepting demand and other types of deposits that are customary in that country. SIB's own literature, however, acknowledges that it does not expose itself to the risk of commercial loans, and only lends on a cash secured basis, solely to existing customers.[10]

Possible Fraudulent Scheme

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[7] Given that SIB investment portfolios hold the funds of far more than 100 investors, there does not appear to be any exemption from registration under the Investment Company Act. Moreover, the information provided to investors does not meet the disclosure requirements of a registered mutual fund.

[8] Rule 901 of Regulation S states that as used in Section 5 of the Securities Act, the terms "offer," "offer to sell," "sell," "sale," and "offer to buy" includes offers and sales within the United States but not those that occur outside the United States.

[9] It should also be noted Regulation S does not apply to the offerings of open-end investment companies. Further investigation would be necessary to determine whether SIB is an open-end investment company. Regulation S, Preliminary Note 8; Securities Release 33-6863.

[10] As well, at least one SEC no action letter has suggested that an unregistered foreign investment company can not legally make a private offering in the U.S. pursuant to Rule 506 of Regulation D coincident with a public offering abroad without violating Section 7(d) of the Investment Company Act. *Touche, Remnant & Co; Stein, Roe & Farnham*, 1984 SEC No-Act. LEXIS 2566 (August 27, 1984). This suggests that SIB has violated Section 7(d) of the Investment Company Act.

The CDs being offered appear to be too good to be true. As noted, SIB claims it is investing in "foreign and U.S. investment grade bonds and securities, and Eurodollar and foreign currency deposits" and "securities from established, quality companies and governmental agencies from around the world." Yet, SIB's high interest rates are inconsistent with its claimed portfolio. Minimum guaranteed interest rates since 2000 have ranged from approximately 3.5% to over 6% for short-term investments. For the Index-Linked CD tied to the S&P 500, the minimum guarantee has been approximately 3.5% or a percentage of the return of the S&P 500, whichever is higher. The brochures given to investors indicates that that percentage of participation may vary at the SIB's discretion, but that an example of the return typically given would be ***125%*** of the gain on the S&P 500.[11] We are unaware of any legitimate short-term investment that not only guarantees a return significantly higher than a CD, but allows you to participate to up to 125% of equity market returns. Moreover, the Staff is equally suspicious of SIB's *recurring annual* 3% trailer. We are unaware of any legitimate, short-term, low or no-risk investments that will pay a 3% concession every year an investor keeps his funds invested in any product.[12]

Further, SIB's annual audit casts doubt upon its claims of consistent profitability over the last 20 years. For example, from 2000 through 2002, SIB reported earnings on investments of between approximately 12.4% and 13.3%.[13] This return seems remarkable when you consider that during this same time frame SIB supposedly invested at least 40% of its customers' assets into the global equity market. Ten of 12 global equity market indices were down *substantially* during the same time frame. The indices we reviewed were down by an average of 11.05% in 2000, 15.22% in 2001 and 25.87% in 2002. It is equally unlikely that the portion of the portfolio invested into debt instruments (approximately 60%) could make up the expected losses in the equity portion of the portfolio. For example, in 2002, when the global indices were down 25%, the debt portion of the portfolio would have to generate an approximately 40% return for SIB to generate the 12.4% overall return it claimed in 2002.

Finally, SGC also appears to be engaged in sales practices that are commonly associated with fraudulent activities. The firm pushes its RRs to sell the CDs by engaging in aggressive sales contests. Prizes offered include trips to Antigua and automobiles. One RR has stated that she was fired for her refusal to sell SIB CDs. Moreover, the SGC has refused to provide to the selling RRs any further disclosure other than the minimal information it provides to potential investors regarding the specifics of SIB's investment portfolio.

Possible Misrepresentations/Omissions in Offering Materials

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[11] SIB paid average interest rates of 9.63% in 2000, 9.13% in 2001 and 7.17% in 2002.

[12] Legitimate CD referrals typically pay $100. Mutual fund concessions may be higher than three percent; however, they impose contingent deferred sales charges that are significantly higher than the penalties charges by SIB for early withdrawal. Furthermore, we are not aware of any mutual fund which pays a trailing fee of three percent. Variable annuity concession arrangements are similar to those of mutual funds.

[13] This extrapolation is based upon two premises. First, that the year end revenues were generated from returns on SIB's portfolio, and that customer deposits were the exclusive source funding the portfolio. Second, that customer deposits remained constant throughout the year—assuming, *arguendo*, that investor deposits increased during the year (as we believe) the extrapolated rate of return would be even higher.

The disclosure materials SGC provides to investors are a confusing mosaic. Prospective U.S. investors are given a short, user-friendly sales brochure that makes the offering seem similar to a CD and clearly guarantees investors a minimum interest rate or return. The only place in which risks are broached, however minimally, is a separate small type-face 20 page "Disclosure Statement." For example:

- The sales brochures refer to the product being offered as a CD that offers a "guaranteed" interest rate or a "Guaranteed Minimum Annualized Yield" and claim that the CD "provides a secure way" to participate in the growth of equity markets because it will pay the greater of a minimum guaranteed return or a return based on the increase in equity markets. Use of the terms CD, "interest," "secure" and "guaranteed" are misleading and suggest a degree of safety that is not inherent in the product being offered. Only by carefully reading the fine print in the disclosure statement do prospective investors learn that their entire investment could be lost and that returns are contingent upon returns on SIB's investment portfolios. These several lines pertaining to risk in the disclosure documents are offset by assurances that their funds are invested in seemingly conservative portfolios, such as foreign and U.S. investment grade bonds and securities and an entire page depicting that between 1990 and 2000 SIB always had significant operating profits, and frequently generated multiple million dollar operating profits.
- The disclosure statement contains only generalities concerning how funds are invested. It states that SIB invests in a "global portfolio" which includes "foreign and U.S. investment grade bonds and securities" and that their investment portfolio consists of securities from established, quality companies and governmental agencies from around the world," equities, bonds, government bonds (foreign and domestic), and precious metals. However, former registered representatives have reported to the staff that they suspect investor funds are instead used to underwrite Allan Stanford's burgeoning real estate and construction interests on Antigua and in Central and South America;
- The SIB brochure given to foreign investors does not contain any information regarding the 3% trailer paid to SGC. The materials for U.S. investors note that there is a referral fee of as much as 3%. Given that the CDs are securities and SCG is participating in the distribution of the CDs, pursuant to Exchange Act Rule 10b-10(2)(D), SCG is required to disclose the source and amount of remuneration it received in connection with the transaction.

Investigative Options

SIB's use of a Commission registered broker-dealer in what may be a fraudulent scheme is a matter of significant concern. Certainly, the ability to sell through a U.S. based broker-dealer gives SIB an *imprimatur* of legitimacy to foreign investors. It is quite possible that action by the Commission against SGC for its role in the CD offering could cause the entire scheme to collapse. We believe that sufficient basis exists to investigate further whether SGC and SIB have sold unregistered securities and made material misrepresentations and omissions to investors, whether SGC has failed to adequately disclose all compensation received for selling these products in violation of Exchange Act Rule 10b-10 and failed to maintain required records, and whether SIB should be registered as an investment company.

EXHIBIT 102

(b)(6), (b)(7)c

April 26, 2005
10:30 am

I gave (b)(6), (b)(7)c some of the details from the following paragraph:

Further, SIB's annual audit casts doubt upon its claims of consistent profitability over the last 20 years. For example, from 2000 through 2002, SIB reported earnings on investments of between approximately 12.4% and 13.3%.[1] This return seems remarkable when you consider that during this same time frame SIB supposedly invested at least 40% of its customers' assets into the global equity market. Ten of 12 global equity market indices were down *substantially* during the same time frame. The indices we reviewed were down by an average of 11.05% in 2000, 15.22% in 2001 and 25.87% in 2002. It is equally unlikely that the portion of the portfolio invested into debt instruments (approximately 60%) could make up the expected losses in the equity portion of the portfolio. For example, in 2002, when the global indices were down 25%, the debt portion of the portfolio would have to generate an approximately 40% return for SIB to generate the 12.4% overall return it claimed in 2002.

Could be lying

Could be that invested in Euro or Yen denominated debt securities that are translated back in to dollars, which would give a boost

To make up 10 loss, would have to earn 30-40%; is it possible?

Send documents up

Very busy; can't say when will get to it

Keep it brief; I told him we would send the issuer's documents, even though they are in places self-contradictory, with the return portions highlighted.

9th and E
901 E St
NW
Office of Economic Analysis

Stop 11-1

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[1] This extrapolation is based upon two premises. First, that the year end revenues were generated from returns on SIB's portfolio, and that customer deposits were the exclusive source funding the portfolio. Second, that customer deposits remained constant throughout the year—assuming, *arguendo*, that investor deposits increased during the year (as we believe) the extrapolated rate of return would be even higher.

EXHIBIT 103

RE: Stanford

4/19/2005 11:23:24 AM

From: Prescott, Victoria F.
To: [redacted]@SEC.GOV]
Cc: Preuitt, Julie A. [redacted]@SEC.GOV]; [redacted]@SEC.GOV]

No, I don't mind. However, please do not do so without imbedding in the document a header or footer that claims it is confidential and non public and attorney work product. I should have done that at the outset, and once it leaves the FWDO, we lose control over its distribution.

One thing that will probably help getting assistance from Antigua is the ability to represent that there is criminal interest. My prior experience, such as it is, suggests that this is critical. I have not reached out to criminal authorities because I did not want FWDO enforcement to lose control of the direction this case takes. Nonetheless, I suspect that this is either Ponzi type scheme or a money laundering operation, either of which would be of interest to criminal authorities. I would be happy to help contact criminal authorities, but I hear our relationship with the [redacted] I have some good contacts with the US Attorney's Office for the N. District, which I would be happy to use. I don't know what the internal politics are at DOJ about case jurisdiction that might bear upon the willingness of N. District folks to get involved.

Also, let me know when you want to contact the office of economic analysis. I would be happy to help with this call, but I believe they are more likely to move quickly if the request has the enforcement imprimatur.

Victoria
[redacted]

-----Original Message-----
From: [redacted]
Sent: Tuesday, April 19, 2005 10:01 AM
To: Prescott, Victoria F.
Subject: Stanford

OIA is seeking some info on Stanford. Do you mind if I forward your memo to them?
Sent from BlackBerry Wireless Handheld.

EXHIBIT 104

RE: C.A.S. Hewlett & Co. 1/6/2005 9:31:26 PM

From: Prescott, Victoria F.
To: [redacted]@SEC.GOV]

Thanks!

Victoria

-----Original Message-----
From: [redacted]@SEC.GOV>
To: Prescott, Victoria F. [redacted]@SEC.GOV>; [redacted]@SEC.GOV>
Sent: Thu Jan 06 20:35:03 2005
Subject: Re: C.A.S. Hewlett & Co.

Victoria: I'll be speaking with folks at the fsa tomorrow and will ask them to do some digging re this or point us in the direction of someone who can. Let's talk after I dialogue with fsa (shd be in am).

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: Prescott, Victoria F. [redacted]@SEC.GOV>
To: [redacted]@SEC.GOV>
CC: [redacted]@SEC.GOV>
Sent: Thu Jan 06 14:52:23 2005
Subject: C.A.S. Hewlett & Co.

[redacted]

Thanks for your help. I got your phone messages that your contact person at the FSA had no familiarity with C.A.S. Hewlett & Co. That is helpful, as I would expect the FSA to have been familiar with this firm if they had a reputation as problematic auditors.

However, by the same token, it would also concern me somewhat if the firm is simply unknown, because the firm purportedly has a London office and because Stanford Bank's financials for 2004 reflected $2.82 billion in customer investments. I would have expected that the FSA would have at leaset heard of a firm auditing a bank of this size. Moreover, one of our examiners has reported to me that he was not able to find a website for the firm on the Internet. I did a brief Google search today, and the only reference I found was at http://www.touchenfield.com/comdir/cditem.cfm/182, which also had no website or email address listed. That seems a little odd for auditors handling an audit of this size--and being the suspicious sort, I wonder whether this is a firm that conducts its business from a mail drop slot.

Finally, I am also concerned because Stanford's audited financials reflected equity of $75 million in 2001 and $100 million in 2002; however, a former insider who left sometime during mid 2002 related to me that his understanding is that the bank's equity was much lower. Consequently, I am concerned that the financials are inflated and that the audit work may be flawed.

If you have other contacts who can help us learn more about C.A.S. Hewlett & Co., please let me know.

Victoria Prescott
Senior Special Counsel

Fort Worth Office
Securities & Exchange Commission
1900 Cherry St. Ste. 1900
Fort Worth, TX 76102
(b)(6), (b)(7)c

EXHIBIT 105

RE: Stanford Group 10/29/2004 5:31:43 PM

From: (b)(6), (b)(7)c

To: (b)(6), (b)(7)c @SEC.GOV]

(b)(5), (b)(7)a

I don't see how that would impact the general solicitation or non-exempt offering issues.

(b)(6), (b)(7)c

Office: (b)(6), (b)(7)c
Mobile

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: (b)(6), (b)(7)c @SEC.GOV>
To: (b)(6), (b)(7)c @SEC.GOV>
Sent: Fri Oct 29 18:09:33 2004
Subject: RE: Stanford Group

They're selling 3 month CDs. How about that one?

-----Original Message-----
From: (b)(6), (b)(7)c
Sent: Friday, October 29, 2004 4:44 PM
To: (b)(6), (b)(7)c
Subject: RE: Stanford Group

(b)(5), (b)(7)a

(b)(6), (b)(7)c

Mobile (b)(6), (b)(7)c

-----Original Message-----
From: (b)(6), (b)(7)c
Sent: Friday, October 29, 2004 4:42 PM
To: (b)(6), (b)(7)c
Subject: RE: Stanford Group

(b)(5), (b)(7)a

-----Original Message-----
From: (b)(6), (b)(7)c
Sent: Thursday, October 28, 2004 5:39 PM
To: (b)(6), (b)(7)c
Subject: Re: Stanford Group

(b)(5), (b)(7)a

(b)(6), (b)(7)c
Office: (b)(6), (b)(7)c
Mobile

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: (b)(6), (b)(7)c @SEC.GOV>
To: (b)(6), (b)(7)c @SEC.GOV>
Sent: Thu Oct 28 18:00:36 2004
Subject: FW: Stanford Group

(b)(5), (b)(7)a

From: (b)(6), (b)(7)c
Sent: Wednesday, October 27, 2004 4:35 PM
To: (b)(6), (b)(7)c
Cc: Prescott, Victoria F.; Wright, Hugh M.
Subject: Stanford Group

I spoke to Leyla Basagoitia (b)(6), (b)(7)c who is an ex-rep with Stanford Group. She was hired about three years ago and paid a sign-on bonus of $150K primarily because of her Hispanic client base. She says she was terminated after two years because she would not sell the "CDs" from the Stanford International Bank. She said other reps were likewise terminated for the same reason. She said she always believed the Antigua CDs amounted to a Ponzi scheme that would one day collapse. She said she reviewed the financials as part of her due diligence and concluded that they were not reliable. She said there is no regulatory authority in Antigua and that Allen Stanford owns at least half the island. Basagoitia said she knows of no one who has lost money on these CDs at this point. Her guess is that they have been sold for about eighteen years.

Basagoitia's arbitration case no. is 03-02025 which she lost on contractual issues. She said she brought up the fact that these CDs were not suitable investments and that is the reason she was terminated. She has the names of the other reps and would welcome the opportunity to give us their names.

Based on our meeting last week and my conversation with this woman, (b)(5), (b)(7)a (b)(5), (b)(7)a In addition, it's reasonable to conclude at this point that the Stanford Group is at least a co-issuer on these CD's. I think that would also eliminate any claim of a Reg D exemption.

EXHIBIT 106

FW: Stanford

12/22/2004 11:24:00 AM

From: [redacted]
To: Prescott, Victoria F. [redacted]@sec.gov]

Victoria□These are the messages, attachments from Leyla

From: Leyla M. Basagoitia [mailto:[redacted]
Sent: Thursday, November 18, 2004 7:18 PM
To: [redacted]@sec.gov
Subject: Stanford

Dear [redacted]

Here are more observations regarding Stanford Group:

1. Commissions on transactions within the B-D and commissions on the offshore bank deposits are paid to all reps in one single check coming from the B-D.
2. Most Reps have offices in Houston, not at the Bank in Antigua. Reps solicit for the bank from their Houston offices, and furthermore Stanford has a private dinning room in Houston from which all reps are allowed to entertain prospects and clients.
3. Clients never talk to people at the Bank. They only deal with their Reps and operations people in Houston. Clients are led to believe the bank is a subsidiary of a regulated US corporation.
4. Management promotes contests among Reps and offices in the US to raise assets for the Bank. Winners are handsomely paid. I was offered a trip to Antigua.
5. If the SEC were to subpoena the Reps and specifically ask under oath whether they solicit from the US, the only answer would be YES.
6. The operation□s manager for the B-D oversees some operations for the Bank. [redacted]
7. Some of the highest producers for the bank are unlicensed people that solicit from the B-D offices in Houston, such as [redacted] who offices in Houston and has no securities license.
8. Most Clients open accounts because they believe the B-D□s clearing agreement with Bear Stearns provides them with account protection. They also believe in the soundness of US laws. Should the Bank not have US representation, clients would not invest as they do at the Bank.
9. Reps are extensively trained to sell the offshore bank. I am attaching a copy of one of my training certificates.
10. The Bank□s new account forms and copies of client□s account records are kept at the Houston offices as well as in Antigua.
11. Another practice was to encourage Reps to open managed accounts, where as the money manager would allocate disproportionate amounts to the Bank.

Sincerely yours,

Leyla B

EXHIBIT 107

Basagoitia Leyla
Tel. [redacted]
December 20, 2004
4:40 pm

I contacted Leyla to get more information about her allegations against Stanford.

Sent [redacted] a letter with all her concerns and outlined everythihg she saw that was a problem and why she was dismissed.

Wanted her to sell offshore bank

When she was hired [redacted] was manager; she transferred her book to Stanfor (from Bear Stearns)

Stnaford Group
Has bd that clear via BS
Bank in Antiguqua—sells cds from US and Mexico and everywhere;

Per [redacted] the bank manages a hedge fund
She thinks it is like a ponzi scheme
Never want to show the portfolio--invest in currency, stocks bonds, options
She asked to see the portfolio—told it was proprietary info and do not show it; she asked [redacted]
Get high trailers
Whenever someone brought money into the bank it was a big deal; emails and congratulation
They were having contests to see who could bring the most money in the bank

Offices outside US: Mexico; Columbia, VZ,

They say are in Houston and clear via BS

Seen it happen before—Inter Americas is similar—also cleared via BS and had Antiqua; [redacted]; United America

She feels that they should disclose what their portfolio is at any time to investors, just like a mutual fund

Investors think the investment is very safe; in reality, investing in very risky investments; stocks, bonds, currentcy—she saw reports

When hired, have to go through training for bank; naf for bank are in Houston; everyone solicit from Houston.

She does not think that overseas investors are getting the same disclosure information as US investos

At the bd in Houston, they have seminars for investors to invest in the bank—brokers bring accredited investors to seminar to invest in CDs

She worked with [redacted] in UA case

She is worried that the portfolio value is far less than their cd obligations, but can not prove it.

Asked about sales presentations and whether any thing false:
Sales behind a quarter; say invested in various stocks and already sold ; always too good to be true; a

At this point, she put me on hold and then we were disconnected

Inter America
Gamma—also cleared through BS—same thing as Stanford.

[redacted]—former branch manager

[redacted]

[redacted] can give more names too—let go the same day as Lelyla
Came from [redacted]

Lelya's email:: [redacted]

NASD hearing 1-19-05 on note

Standford's financials not audited by us firm; small group over there.

She thinks that all the investments that underlie the cds are being done from the US; she thinks that it is invested from Denver.—dnr names of trader—some in Houston too. [redacted] [redacted] would know

EXHIBIT 108

(b)(6), (b)(7)c

December 28, 2004
11:15 am

Returned his call (b)(6), (b)(7)c

Left 2.5 years ago; at that point, there were 3 CD products
Longest was fixed rate: vehicle touted as CD, guaranteed by Stanford International Bank; money goes in and invested; from what he could see it was a hedge fund and they invested in stocks, bonds, metals, futures etc and paid the stated rate in the offering memo; structured to look like a CD but basically deposit with bank and they do with it what they want; it is really like an offshore investment company; they were very touchy about it not being called a security;

He thinks it looks like a hedge fund

Majority of deposits from offshore investors; Mexico, Chile, Brazil, S. American

Complied with anti money laundering stat. But he was concerned that if Mexican Peso took a hit and all sought money, could not get it back

Alan Stanford is sole owner; equity minimal--$5-10m
Reserves very minimal
Intense pressure on domestic FCs and managers to push CD product

Most of the money that comes to the bank is not via the US Broker dealer

They hired me from (b)(6), (b)(7)c to be a highend financial planner a la Goldman Sachs, but the big thing was the offshore fixed cd that paid high rates; a lot of smoke and mirrors; apparently usually had remarkable returns, and kept the spread

Offering memo says that any disputes or litigation has to be in Antiguan court.

Brought out indexed cds just before he left; just like a US indexed CD; he understood that they may buy some indexes to hedge it, but basically took the dollars and figured they could outperform the index rate. Offered originally only to accredited investors; big issue as to how many could offer it to; he understands third hand that they got an opinion from a noted former NASD? Or SEC atty that it was a security and hence could not offer to more than 49 investors; at this point already had 600-700 us investors in it

He thinks, after being forced to offer it under extreme pressure from Stanford, that it looks like a hedge fund

He thinks the potential risk is played down; public seminar for accredited investors in 2001 that he attended: they went through how able to pay high rates; showed % of

futures, stocks for fixed CD; he felt that they showed returns far better than what stock market produced.

The index cd was just coming out when he left; positioned like a index cd or index annuity in US where guaranteed by bank but after term of investment, if index outperforms rate of return, get 85% of the better return; it was slated and felt like an index cd seen in US banks.

They did not tell you how they would get these numbers. He thinks some money hedges in options in indexes, but majority simply invested—majority of portfolio in fixed product was in US equity markets and bonds; had commodity and futures managers; like a fund of funds; a hedge fund

His big concern was the risk potential there, yet cloaked as conservative investment.

He does not know what office was making the investments underlying the CD, or if it was even in US; He had Houston and Baton Rouge as responsibility; he did not handle this; he heard and saw some revenue runs that showed large fixed income trades going through Stanford Group in Houston; on trade blotter at BS would be a labeled account Stanford International Bank—would have institutional unit account numbers

His sense is that as long as show good returns, people invest and roll over, in most months always a net new money gained rather than a net outflow from the bank; 90% of assets came in from offshore investors and only 10% from US investors; most looking for a currency haven; get money out of Mexico to protect against devaluation of Peso;
His concern that with equity markets down year after year, if ever a currency problem, and there was a run on the bank, would have to borrow or dip into US clients funds to pay. The reserves are so thin that a run on the bank could cause the house of cards to fall;

He had several offshore producers with $150-200m of assets; they were under pressure from Alan Stanford to put money in bank; they were uncomfortable putting large amounts of their clients funds in the bank

Had currencies, equities, venture funds

Of what is invested in Stanford bank, he thinks better than half is invested through international offices; rest via US broker dealer; they had hoped for more investments via the US broker dealer, but many US investors proved skeptical about putting money offshore

Revenue was 100 basis points per year or more
Some of sales incentives offered by Alan Stanford were bizarre; for $1million assets deposited in a month get $100k automobile; he never saw any actually awarded, but he heard that (b)(6), (b)(7)c, one of the international producers based in Mexico got a Mercedes

Assets into bank: goals to send $1 to 2.4 million per month from each office; at that time, Miami, Denver, Baton Rouge and Houston;
Miami was success
Houston hit and miss
Batron Rouge sold a lot; sometimes outproduced Houston and Miami
Denver did poorly

Houston less than 40%; significant part of office is non resident alien bus;
Miami is all non resident alien—almost 100%

His counterpart in Miami: (b)(6), (b)(7)c
He was in Miami from until 2001

(b)(6), (b)(7)c —Denver
Robert Glenn—Denver—was on bod at Stanford

Email (b)(6), (b)(7)c

Stanford has (b)(6), (b)(7)c in his pocket; made several large contributions to (b)(6), (b)(7)c

Also made large contributions to PM in Antigua

Stanford's right hand is a woman; dnr name; atty in US; (b)(5), (b)(7)a
(b)(5), (b)(7)a ; now in Miami; she is employed by Stanford financial Group

EXHIBIT 109

(b)(6), (b)(7)c

January 6, 2005
11:15-11:50 am
vfp

Bank equity in 2002 5-7 million
Convoluted: equity in bank plus equity Alan Stanford contributed; he recollection is that it was $15 million total; Stanford was complaining about having to contribute another $5 million to the bd for net capital equity requirements

I explained to him that bank 2002 reflected $100 million; a big difference from the $5-7 million that (b)(6), (b)(7)c understood: (b)(6), (b)(7)c thinks that this may be the spread between what Stanford owed on CDs; (b)(6), (b)(7)c explained that he had to make a $5-7 million contribution to net capital to the broker dealer.

Reserves were very small for the bank and the deposits were very large. His information was from the audited financials;

The $100 m strikes him as extremely high—he thought total bank deposits were 300-500 million for 2002 so reserves of $100 million would be surprising; he does not think total deposits were more than ½ billion and reserves no where near $100.

He left in early (b)(6), (b)(7)c

The $75 million figure for 2001 seems high

Wanted to know if I spoke to (b)(6), (b)(7)c

Glen is gone from Stanford—he was on bod of bd; also sat in on a lot of board meetings with Alan Stanford
(b)(6), (b)(7)c is not there either; both left Stanford prior to

(b)(6), (b)(7)c is in Denver and is a friend of Bob Glenn—close friends

(b)(6), (b)(7)c would know about the bank; he had prior banking experience prior to Stanford and his business in Miami was mostly with the bank

Bd was tool of Alan Stanford to raise money for the bank; did not work well and Stanford turned up the pressure to sell the product.

Rep got 1% per year for as long as the money was invested

The opinion that the cd was a security: (b)(6), (b)(7)c sat in on board meetings along with director of compliance and Yolanda Suaraz, Stanford's right hand "man" ; president and vp of bd were in these meetings; there was a discussion at a meeting about being sure that the cd could be sold to accredited investors; working on getting cleared to sell to unaccredited

investors; at this point, director of compliance for the bd mentioned at meeting and Stanford blew up; she had spoken to a close friend of hers who was a former NASD or SEC atty that it was a security and should only be sold to 49? accredited investors; at the time sold to over 100 accredited investors. Stanford and Suarz blew up at this point in the meeting. Jane Bates was the compliance person. Her friend was a female atty in DC. Bates is still with the firm. This caused Stanford to blow up and Jane Bates was almost in tears; he thinks [redacted] and [redacted] heard this too,

Seminar in 2002: they minimized risk: % of total portfolio in volatile investments such as stocks, commodities, futures, etc were shown as part of the total portfolio, but when they spoke about them, spoke only of upside, not the potential downside; spoke of what they though could do; same with index options.; never disclosed the flip side of risk

Based on what he saw, these volatile investments were never a large part of the portfolio—they were vague about the actual allocation; intimated that vague b/c proprietary secret; he recalls that currencies, options were 10% or less; they were conspicuously vague about %; they intimated that asset allocation model was propriety secret

[redacted] does not recall any discussion of risk; they did a great job of assuring that only accredited investors were invited to seminars and they couched it as a cd investment; he does not believe there was ever any discussion of loss of principal; they said that this looks too good to be true, and here is how we have done it in the past; if you give us $100k, part of the magic was the asset allocation of stocks, bonds, futures, currencies, options etc.

[redacted] was also concerned that since significant amount of investments from Latin America, a devaluation of the peso could cause a run

The firm would not reveal to registered reps how the money was invested; even at [redacted] level they were very vague—40% eq; 40% fixed; rest commodities--

EXHIBIT 110

(b)(6), (b)(7)c

January 11, 2005
1:00 pm
Out to lunch; left name and number with an associate with request to call me back.

Returned my call from (b)(6), (b)(7)c at 2:00

(b)(6), (b)(7)c was the managing director and I went with him to be the sales manager

Alan Stanford is an enigma

The operations of the bank are not transparent and they won't divulge this information; they will say it is invested in x% in stocks and x% in bonds—it was an attractive rate when I was there b/c stock markets so bad; they were paying 9%; but it does not follow the market; now paying 6% per one former client or associate

In 2003, if 50% in equities, would have a good year

In presentations would say that they have an process that worked; short in down markets

Bank is the number one priority for Alan Stanford
But US citizens do not want their money off shore
The more I learned about Antigua, the more I was concerned; (b)(6), (b)(7)c
(b)(6), (b)(7)c was in power for 30 years and was corrupt

Alan was putting so much money into Antigua; building on Antigua; dnk what source of money was;
New administration in place and now country is having fiscal problems

My background is (b)(6), (b)(7)c years in banking and then (b)(6), (b)(7)c with (b)(6), (b)(7)c then regional firms—(b)(6), (b)(7)c; Stanford was the worst experience had; not run for the domestic brokerage side; I was sales manager but did not get much approval authority ; I just tried to help (b)(6), (b)(7)c run the office

The international bankers who did a lot w/ Mexico
Domestic side too
About 26 brokers there—ran the domestic side normally

Sales presentations about cds by (b)(6), (b)(7)c —few allowed to do it; from what I saw of documents it was pretty extensive disclosure about risk; documents written to the point that some of us wondered how to market as a cd b/c said could lose money; higher return;

Compliance officers:

Sent us to Miami for training on the bank; I asked if lending to other entities; not; if had a loan would have to disclose

Sales presentations in groups and one on one
Had lists of accredited investors; one rep was almost exclusively marketing the bank; he was working on that side; buying lists of accredited investors; he did not see verification and does not know where bought list or if verified accreditation status

I really never found anything that I totally felt was fraudulent about the representation—just little info on how it was managed;

Clients I had stayed in short maturity and were able to get funds out; no trouble getting funds back; he thinks wired from Antigua to NY bank

He saw some group presentations: as to risk, what was said; dnr how addressed risk; bulk of presentation was focused on history of the company and the bank; returns of bank—profits of bank and historical cd returns;
Done by bond market; normally (b)(6), (b)(7)c and (b)(6), (b)(7)c —two senior people in bond dept; (b)(6), (b)(7)c (b)(6), (b)(7)c was the front man

I left two years ago; difficult organization
Alan Stanford is in b/g; seldom in Houston; mostly in Miami; hard to figure out

Denver office did not produce much of CDs and they just shut the office down about two to 2.5 years ago; the manager hired a lot of young people and put them on salary and the office was not doing well.

Group sales presentations less than an hour; held at the Stanford building; they have an auditorium

Got Annual report from bank and quarterly updates from bank;
We asked a lot of questions; Jim Davis' group in Memphis managed the money; they would not give us all the investment process; asked us to look at the history; Davis and Alan Stanford have been friends forever
They handle investments for the bank and for Alan; Jim Davis is the coo and is on the bod

Never saw improper procedures; it was a different entity to market to US citizens; he thinks the bulk of the money from overseas; they returned money to someone they did not like the b/g of; dnk what the question was, but the source of the money was reported to regulators and turned over to them

They shorted positions; Laura Pendergraft is the chief investment officer and one presentation given discussed some of the investment techniques such as shorting money and hedging positions when the market was down; they did not seem to do well when the stock market was doing well--dnk why did not do well when market up; we were never

told anything about the other operations; Alan has so many corporations; real estate in US; this is where Alan and his father made most of their money; when Houston was depressed, Alan and father bought lots of property;

Also several refineries in Caribbean were closing—Exxon, Shell, Mobil etc; they made presentations to retirees getting distributions and they were soliciting investments into real estate portfolios they had; bought a bank—ultimately became Stanford Bank—on a different island and moved to Antigua—Marecia or something like that

I never knew what other entitles Alan had; a bunch of corporations; 40-50 corporations at least; bought an airline in Antigua at one point; really invested a lot in the island and has duel citizenship; I never though there was enough commerce in Antigua to justify all that; Stanford bank is probably the biggest thing on the island;

(b)(6), (b)(7)c was a managing director;
(b)(6), (b)(7)c was there when I was there; she was a broker; now with insurance company: mobil : (b)(6), (b)(7)c
(b)(6), (b)(7)c is another; dnk #; we were there about the same time

(b)(6), (b)(7)c —now at Smith Barney in Galleria

While I was there the whole domestic brokerage side turned over; not like the international side which had no turnover;
just a different operation than what we were used to; de-emphasis –cutting more research—cut CS Boston; limited from Goldman; did not provide enough of the traditional support to brokers

Had S& P research and that was about it

He has only one client left there; his client is (b)(6), (b)(7)c H: (b)(6), (b)(7)c
W (b)(6), (b)(7)c

When cd matures, pretty easy to get money moved; just not transparent as to investment process; most of us felt that with the market where it was, a 9% return was good and my clients understood that there was some risk; I told my clients it was not an FDIC insured cd—they were 3% at the time.

Email: (b)(6), (b)(7)c

We could not cold call; were to sell only to accredited investors.

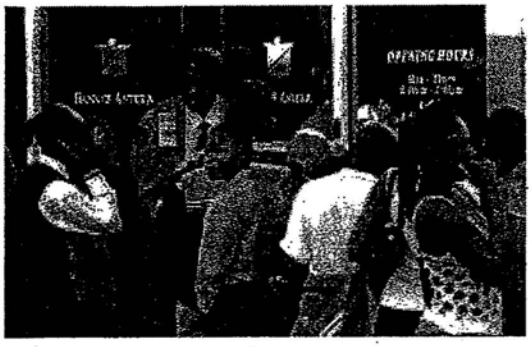
EXHIBIT 111

chron.com

Past probes sought to tie Stanford to drugs

By ROMA KHANNA, STEWART M. POWELL and JANET ELLIOTT Copyright 2009 Houston Chronicle

Feb. 20, 2009, 10:06PM



Andres Leighton AP

A guard speaks with Bank of Antigua customers lined up outside the St. John's branch Wednesday. Antigua's Prime Minister Baldwin Spencer urged people not to panic over a U.S. fraud probe involving R. Allen Stanford.

Authorities for years have investigated R. Allen Stanford, looking for ties to organized drug cartels and money laundering, going back at l east a decade when the Texas billionaire's offshore bank surrendered $3 million in drug money, state and federal sources told the Houston Chronicle Friday.

But no one has ever been able to make a criminal case.

Texas securities officials investigated, as did the U.S. Drug Enforcement Administration and the FBI. But none found solid evidence of a link between drug money and Stanford, who now stands accused of running a multibillion-dollar fraud at his offshore bank in Antigua and Houston-based brokerage firm.

In the late 1990s, according to court documents, operatives of the Juarez cartel began opening accounts at Stanford's Antigua-based bank in an effort to launder money amassed under one of Mexico's most vicious drug lords, Amado Carrillo Fuentes. Together, they used Stanford International Bank to open 10 accounts and deposit $3 million — a small sliver of the cartel's fortunes but enough to pique authorities' interest.

Now, more than a decade later, federal sources tell the Chronicle, any alleged Stanford connection to drug cartels and their money could lie buried in the paperwork gathered for the Security and Exchange Commission's civil inquiry.

Efforts by the Chronicle to reach Stanford through his lobbyist have been unsuccessful.

FBI involved again

The SEC only has the authority to pursue civil actions, leaving the decision to pursue criminal charges to the Justice Department and FBI. An SEC spokesman indicated that the FBI was examining documents and other materials seized in the SEC's fraud probe.

"We are certainly in contact with the SEC and we

are aware of their investigation but we are not going to discuss any ongoing matters," said FBI Special Agent Shauna Dunlap.

Stanford, a once high-flying businessman whose investment firm's affiliates stretch from Bogota, Colombia, to Quito, Ecuador, has denied having ties to foreign drug barons and never has been charged with a crime related to his banking. In 1999, Stanford willingly turned over the $3 million from his bank after federal agents found it had come from a drug cartel.

In fact, at the time, Stanford's cooperation won him praise from authorities who said he had not intentionally accepted drug money.

Around the same time, however, Texas securities regulators found evidence of potential money laundering involving Stanford, an official said Friday in Austin. But, because the activity involved offshore banks, it was referred to the FBI and SEC.

"Why it took 10 years for the feds to move on it, I cannot answer," Securities Commissioner Denise Voigt Crawford told the Senate Finance Committee in Austin. Later, she added, "We worked with the FBI and the SEC and basically gave them the case. We told them what we'd seen and they were going to run with it."

Difficult to prove

DEA sources also confirmed to the Chronicle their own investigation of potential ties between Stanford and Latin America drug traffickers. But tracing international wealth and investment, as well obtaining proof that someone knowingly engaged in fraud or laundering, is difficult to document.

"We've never been able to prove that," DEA spokesman Garrison Courtney said. "If we could, it would have been part of the case."

Antigua and other Caribbean islands have long been seen as places where international bankers are willing to take in big money from foreigners and not ask a lot of questions. In 2007, the nation of Antigua and Barbuda had 17 offshore banks, three offshore trusts, two offshore insurance companies and 3,255 international business corporations, according to the U.S. government produced International Narcotics Control Strategy report.

That would equate to nearly one corporation for every 20 people living on this island.

Mike Vigil, who retired from the DEA but was the agency's chief of international operations and ran its Caribbean office, said island banks "have always been a focal point for laundering illicit drug proceeds and Antigua has always been a primary center of money laundering operations for many significant drug traffickers."

Chronicle staff writer Dane Schiller contributed to this report.

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stewart.powell@chron.com

janet.elliott@chron.com

EXHIBIT 112

U.S. Securities and Exchange Commission

SPENCER BARASCH, HEAD OF ENFORCEMENT FOR THE SEC'S FORT WORTH OFFICE, TO LEAVE THE COMMISSION

FOR IMMEDIATE RELEASE
2005-34

Washington, D.C., March 9, 2005 - The SEC announced today that Spencer C. Barasch will leave the Commission in April to become a partner in the Dallas office of the law firm of Andrews Kurth LLP. For the past seven years, as the senior enforcement official in the Commission's Fort Worth Office, Barasch has led the Commission's enforcement program in a four state area of the Southwest. Before that, he held various other positions in the Commission, including Assistant Director in the Commission's Southeast Office in Miami, Fla.

As the enforcement head in the Fort Worth Office, Barasch, 47, directed a number of high profile SEC enforcement investigations and litigation in several areas of the securities industry. Among the more noteworthy enforcement actions he oversaw were:

- major financial fraud cases involving Royal Dutch Shell, Halliburton, TV Azteca, and the Fleming Companies;
- regulatory cases against AIM, Southwest Securities, First Command and HD Vest;
- significant insider trading cases involving the securities of Hispanic Broadcasting Corp., AmeriCredit and Carreker Corp; and
- more than 50 emergency enforcement actions involving securities scams targeting inexperienced investors, recovering close to one billion dollars for investors.

Harold F. Degenhardt, head of the Commission's Fort Worth Office, said, "Spencer Barasch has been central to Fort Worth's significant enforcement accomplishments. The ascendancy of its enforcement program is in no small part due to his efforts. We lose, however, more than just an outstanding professional, wholly committed to the Commission's mission, we lose a friend ...he will be missed."

Stephen Cutler, Director of the SEC's Enforcement Division, stated, "Spence's dedication to the work of the Commission has been second to no one. He is the consummate enforcement lawyer: smart, tough, fair and tireless. I will miss him and so will the Commission."

Barasch said, "I cannot imagine a more rewarding professional experience than having the privilege and honor to represent and protect the investing public as a staff member of the Commission. I am especially proud of the extraordinary accomplishments of my colleagues in the Commission's Fort Worth office, who, through their terrific talent, dedication and zeal, have established a reputation for excellence that is an inspiration to me and others throughout the Commission. I have been extremely fortunate to work with so many exceptional colleagues throughout the Commission, and will greatly miss them and the important work that the Commission performs. "

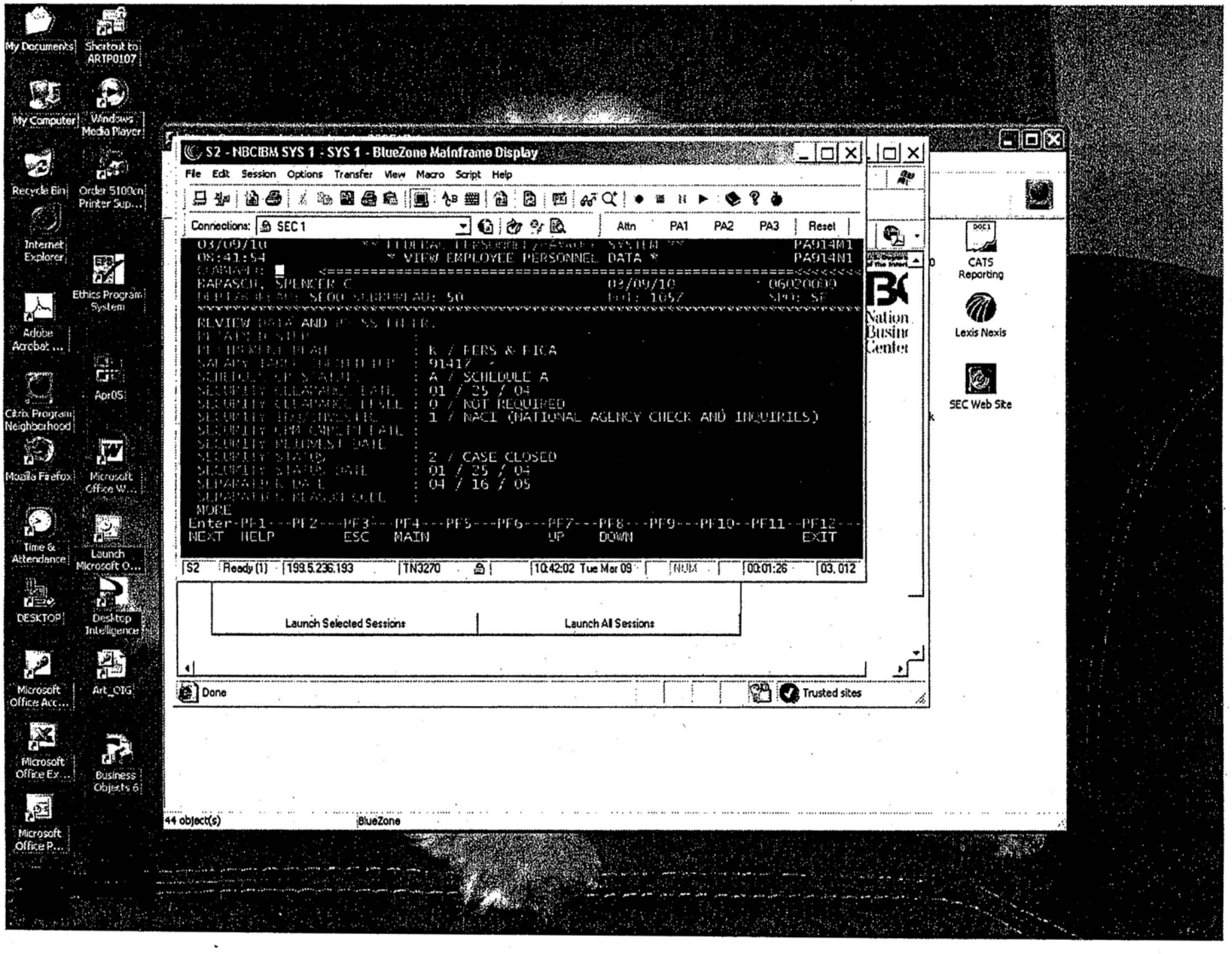
Barasch received a number of awards during his tenure with the Commission, including the Irving M. Pollack Award for his dedication to public service and the SEC, and his fairness and compassion in dealing with the public and the staff.

Before joining the Commission staff in 1987, Barasch was Associate General Counsel for the Oklahoma Department of Securities. Barasch received his J.D. from the University of Tulsa in 1984, and his A.B. from Duke University in 1980.

http://www.sec.gov/news/press/2005-34.htm

Home | Previous Page Modified: 03/09/2005

EXHIBIT 113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File Edit Session Options Transfer View Macro Script Help
Connections: SEC 1
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BAPASCH, SPENCER C 02/09/10 06020000
DEPT/BUREAU: SE00 SUBBUREAU: 50 EMP: 1057 SPEC: SF
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ADJUDICATOR :
INVESTIGATION PLAN : K / PERS & PICA
SALARY GRADE : 9141
SCHEDULE OF SALARY : A / SCHEDULE A
SECURITY CLEARANCE DATE : 01 / 25 / 04
SECURITY CLEARANCE LEVEL : 0 / NOT REQUIRED
SECURITY ISSUE INSTRS : 1 / NACI (NATIONAL AGENCY CHECK AND INQUIRIES)
SECURITY CPF CONCLUDED :
SECURITY REQUEST DATE :
SECURITY STATUS : 2 / CASE CLOSED
SECURITY STATUS DATE : 01 / 25 / 04
SEPARATION DATE : 04 / 16 / 05
SEPARATION REASON CODE :
MORE
Enter-PF1---PF2---PF3---PF4---PF5---PF6---PF7---PF8---PF9---PF10--PF11--PF12---
NEXT HELP ESC MAIN UP DOWN EXIT
S2 Ready (1) 199.5.236.193 TN3270 10:42:02 Tue Mar 09 NUM 00:01:26 03, 012
Launch Selected Sessions
Launch All Sessions
Done
Trusted sites
44 object(s)
BlueZone
My Documents
Shortcut to ARTP0107
My Computer
Windows Media Player
Recycle Bin
Order 5100cn Printer Sup...
Internet Explorer
Ethics Program System
Adobe Acrobat ...
Apr05
Citrix Program Neighborhood
Mozilla Firefox
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Time & Attendance
Launch Microsoft O...
DESKTOP
Desktop Intelligence
Microsoft Office Acc...
Art_OIG
Microsoft Office Ex...
Business Objects 6
Microsoft Office P...
CATS Reporting
Lexis Nexis
SEC Web Site
Nation Busine Center

EXHIBIT 114

Re: Stanford 4/8/2005 5:44:00 PM

From: Preuitt, Julie A.
To: [redacted] @SEC.GOV]; [redacted] @SEC.GOV]

Don't believe so. Think he became an Antiguan citizen, but started out something other than US. Have to check with those smarter than me next week. Its probably on the web. Stanford is a very, very, very important person in Antigua.

From: [redacted]
Sent: Friday, April 08, 2005 4:44 PM
To: Preuitt, Julie A.
Subject: RE: stanford

I'm only speculating that some of the other agencies (FBI, DHS, State) may be able to get cooperation from the Antiguan authorities that we might not. Important question: does Robert Allen Stanford have residence, property, citizenship or other connections to U.S., aside from SGC?

From: Preuitt, Julie A.

Sent: Friday, April 08, 2005 4:41 PM

To: [redacted]

Subject: RE: stanford

Cool. I don't quite understand how they can go after bad guys in other countries, but in light of all the stuff that has happened since criminal authorities were looking pre 9/11 I bet they would be far more interested now!

From: [redacted]
Sent: Friday, April 08, 2005 4:38 PM
To: Preuitt, Julie A.
Subject: RE: stanford

It's OK. After we talk to Victoria, I can do some checking of my own. Key is probably to get one of the other agencies interested in the money laundering, drugs/terrorism aspect, and then ride their coat tails for the overseas action.

From: Preuitt, Julie A.

Sent: Friday, April 08, 2005 4:36 PM

To: [redacted]

Subject: RE: stanford

Victoria has tried to get info from OIA regarding Antigua. I don't think she got much info. Stanford Bank chides among other things the secretive banking laws in Antigua. I think the Justice Dept. was looking into this a few

years ago out of Miami. I believe they are quite limited in their actions because all the illegal activity, except the broker-dealer stuff, occurs over seas and the broker-dealer stuff isn't criminal. Sorry I don't have better detail.

From: (b)(6), (b)(7)c
Sent: Friday, April 08, 2005 4:32 PM
To: Preuitt, Julie A.; Prescott, Victoria F.
Cc: (b)(6), (b)(7)c
Subject: RE: stanford

Has anyone spoken to OIA about what our resources in Antigua? Even if they can't point us to any solutions, the FBI, State Department, and other agencies may be able to help. I just haven't looked into it.

From: Preuitt, Julie A.

Sent: Friday, April 08, 2005 4:28 PM

To: (b)(6), (b)(7)c Prescott, Victoria F.

Cc: (b)(6), (b)(7)c

Subject: RE: stanford

Victoria will have difficult getting any time together next week before Friday. Right now a hearing is set on Thursday in Amarillo as a follow up to the temporary freeze granted today. Unless her schedule changes, lets look at Friday.

I agree. The memo is good. The problem is very interesting. We agree with many of your concerns. Its a difficult choice. It seems too difficult to go after the foreign entity so nothing happens or it seems too limiting to go after the US BD when we know the whole thing must be a fraud. As a result, we've just sat around for ten years fussing about what is going on at this firm/bank.

(b)(6), (b)(7)c and (b)(6), (b)(7)c did the examination. In case you didn't already know – they are awesome.

From: (b)(6), (b)(7)c
Sent: Friday, April 08, 2005 4:23 PM
To: Preuitt, Julie A.; Prescott, Victoria F.
Subject: RE: stanford

Victoria, this memo is terrific. Very nicely done.

Moreover, I agree with the preliminary legal conclusions in the memo, including the deduction that this almost certainly has to be fraudulent.

I would like to get together with both of you and talk in greater depth about possible courses of action. From a tactical standpoint, the international dimension concerns me because it limits our investigative powers. The BD is domestic, of course, but I'm concerned that taking action only against the domestic BD will have a limited long-term effect on the whole apparently-criminal organization, most of which is overseas. Moreover, the immediate impact on U.S. investors of an action against the domestic BD might not be favorable. Finally, I would want to coordinate anything we do with the FBI, because the likelihood that this organization is linked to terrorism, narcotics, or some other very bad conduct, strikes me as

likely.

Monday is the only day next week that is NOT good for me.

From: Preuitt, Julie A.

Sent: Tuesday, April 05, 2005 11:30 AM

To: (b)(6), (b)(7)c

Cc: Prescott, Victoria F.

Subject: FW: stanford

Victoria put this together. I think it does a great job of summarizing our concerns. It has been looked at by Hugh, but not by anybody in enforcement.

I don't think we can get the Bank (be clear when you read), but I do think that we can get the BD which will ultimately get the Bank. A LOT of money involved.

<< File: Stanford Memo to HMW2.doc >>

EXHIBIT 115

Fw: Stanford 4/13/2005 6:04:19 PM

From: Cohen, Jeffrey A.
To: (b)(6), (b)(7)c @SEC.GOV]
Attachments: Stanford Memo to HMW2.doc

Besides the insider trading matter, what's (b)(6), (b)(7)c handling? Does she have time for this one?

From: (b)(6), (b)(7)c
Sent: Tuesday, April 12, 2005 5:45 PM
To: Cohen, Jeffrey A.; (b)(6), (b)(7)c
Cc: Preuitt, Julie A.; Prescott, Victoria F.
Subject: FW: stanford

I've reviewed this and spoken to Victoria and Julie, and I believe this case is worth pursuing. Victoria's memo (attached below) does a good job of laying out the apparent violations. If, after reviewing it, you find yourself wondering why I thought the case was worth pursuing, let me know. I don't think that will be your reaction, but I'm happy to share my impression of this if it would be helpful.

With (b)(6), (b)(7)c leaving, I don't have anyone to work on this right away. Depending on who we get to fill (b)(6), (b)(7)c slot, the new person might be able to handle this, but if one of you has someone with time to work it right now, that would be even better. I know (b)(6), (b)(7)c group is loaded up with cases out of the exam program already, but I wanted to make both of you aware of this.

One of the obvious logistical and jurisdictional problems with this case is the location of the issuer in Antigua. Please note, however, that Robert Allen Stanford, who is apparently the control person for the entire fraudulent enterprise, has a residence in Houston and holds a Texas driver's license. How much time he spends at that residence, and how much it is worth, remains to be determined, but it's more of a U.S. connection than I initially was aware of.

Concerning such matters as property, addresses and other vital statistics, (b)(6), (b)(7)c already ran Stanford and some related names in a search program of some sort, and came up with a large volume of information that I can forward to anyone who ends up working on this.

Please let me know whether you have someone who could take this over.

THANKS

(b)(6), (b)(7)c

(b)(6), (b)(7)c

Division of Enforcement

Fort Worth Office

(b)(6), (b)(7)c

From: Preuitt, Julie A.

Sent: Tuesday, April 05, 2005 1:29 PM

To: (b)(6), (b)(7)c Cohen, Jeffrey A.; (b)(6), (b)(7)c

Cc: Prescott, Victoria F.

Subject: FW: stanford

Victoria put together the attached memo. I think it does a good job of explaining our concern out at Stanford. (b)(6), (b)(7)c has already volunteered to take a quick read so don't worry (b)(6), (b)(7)c or Jeff if you don't have time to look at it right away.

<<...>>

EXHIBIT 116

Stanford Group Company 4/14/2005 5:17:00 PM

From: (b)(6), (b)(7)c

To: Prescott, Victoria F. (b)(6), (b)(7)c @SEC.GOV]

Cc: Preuitt, Julie A. (b)(6), (b)(7)c @SEC.GOV]; (b)(6), (b)(7)c j@SEC.GOV]

Your memo was fantastic. Will be very helpful going forward. (b)(6), (b)(7)c and I are opening MUI with hope of bringing case quickly (possibly TRO). May need some help from you and others in reg to make it happen.

(b)(6), (b)(7)c

(b)(6), (b)(7)c

Division of Enforcement

Securities & Exchange Commission

801 Cherry Street

Fort Worth, TX 76102

Phone: (b)(6), (b)(7)c

Fax: (b)(6), (b)(7)c

EXHIBIT 117

Re: Stanford 4/15/2005 11:42:00 AM

From: Cohen, Jeffrey A.
To: (b)(6), (b)(7)c @SEC.GOV]

That would be very helpful. Thanks!

From: (b)(6), (b)(7)c .
Sent: Friday, April 15, 2005 10:43 AM
To: Cohen, Jeffrey A.
Subject: RE: stanford

Definitely. I don't know whether I already sent it to you, but (b)(6), (b)(7)c ran several reports on Robert Allen Stanford that show a lot of address and real property information. I'll forward those in case I did not already.

From: Cohen, Jeffrey A.

Sent: Friday, April 15, 2005 10:41 AM

To: (b)(6), (b)(7)c

Subject: RE: stanford

My (tentative) plan is to focus, at least initially, on their stateside sidekick: the B-D. That's a bird in hand.

From: (b)(6), (b)(7)c
Sent: Friday, April 15, 2005 10:30 AM
To: Cohen, Jeffrey A.
Subject: RE: stanford

I'll be interested to hear how you manage the overseas aspects of this. Might be some good lessons for all of us in that.

From: Cohen, Jeffrey A.

Sent: Friday, April 15, 2005 10:29 AM

To: (b)(6), (b)(7)c

Subject: RE: stanford

Thanks. It does look promising.

From: (b)(6), (b)(7)c
Sent: Friday, April 15, 2005 10:28 AM

To: Cohen, Jeffrey A.
Cc: Preuitt, Julie A.; Prescott, Victoria F.; (b)(6), (b)(7)c
Subject: RE: stanford

Glad to hear it -- looks pretty lively to me. If I can do anything to help, I'm happy to do so, but all I did was read Victoria's memo. Accordingly, I don't think I'm really going to have anything to offer from here on. Good luck.

From: Cohen, Jeffrey A.

Sent: Friday, April 15, 2005 10:21 AM

To: (b)(6), (b)(7)c

Cc: Preuitt, Julie A.; Prescott, Victoria F.; (b)(6), (b)(7)c @SEC.GOV)

Subject: RE: stanford

We've opened a MUI in (b)(6), (b)(7)c name.

From: (b)(6), (b)(7)c
Sent: Tuesday, April 12, 2005 5:45 PM
To: Cohen, Jeffrey A.; (b)(6), (b)(7)c
Cc: Preuitt, Julie A.; Prescott, Victoria F.
Subject: FW: stanford

I've reviewed this and spoken to Victoria and Julie, and I believe this case is worth pursuing. Victoria's memo (attached below) does a good job of laying out the apparent violations. If, after reviewing it, you find yourself wondering why I thought the case was worth pursuing, let me know. I don't think that will be your reaction, but I'm happy to share my impression of this if it would be helpful.

With (b)(6), (b)(7)c leaving, I don't have anyone to work on this right away. Depending on who we get to fill (b)(6), (b)(7)c slot, the new person might be able to handle this, but if one of you has someone with time to work it right now, that would be even better. I know (b)(6), (b)(7)c group is loaded up with cases out of the exam program already, but I wanted to make both of you aware of this.

One of the obvious logistical and jurisdictional problems with this case is the location of the issuer in Antigua. Please note, however, that Robert Allen Stanford, who is apparently the control person for the entire fraudulent enterprise, has a residence in Houston and holds a Texas driver's license. How much time he spends at that residence, and how much it is worth, remains to be determined, but it's more of a U.S. connection than I initially was aware of.

Concerning such matters as property, addresses and other vital statistics, (b)(6), (b)(7)c already ran Stanford and some related names in a search program of some sort, and came up with a large volume of information that I can forward to anyone who ends up working on this.

Please let me know whether you have someone who could take this over.

THANKS

(b)(6), (b)(7)c

(b)(6), (b)(7)c

Division of Enforcement

Fort Worth Office

(b)(6), (b)(7)c

From: Preuitt, Julie A.

Sent: Tuesday, April 05, 2005 1:29 PM

To: (b)(6), (b)(7)c Cohen, Jeffrey A.; (b)(6), (b)(7)c

Cc: Prescott, Victoria F.

Subject: FW: stanford

Victoria put together the attached memo. I think it does a good job of explaining our concern out at Stanford. (b)(6), (b)(7)c has already volunteered to take a quick read so don't worry (b)(6), (b)(7)c or Jeff if you don't have time to look at it right away.

<< File: Stanford Memo to HMW2.doc >>

EXHIBIT 118

RE: Update on Stanford

6/3/2005 9:51:39 AM

From: Cohen, Jeffrey A.
To: [redacted]@SEC.GOV]

Good plan. Thanks.

From: [redacted]
Sent: Friday, June 03, 2005 9:04 AM
To: Cohen, Jeffrey A.
Subject: Update on Stanford

Stanford Questionnaires have been sent to both US and foreign investors. [redacted] We ve had trouble getting clear guidance from OIA on how to format our request to Antigua. They initially gave us an example to follow, which we returned to them a couple of days later. On 5/31, OIA then sent us a new example to follow (the new example was significantly different from the previous example). We should have the revised request back to OIA by COB today. The MUI, however, converts on appox 6/12. With luck, OIA will be able to review and submit our request for docs to Antigua by 6/12, but it will be close. I ll keep you posted.

[redacted]

[redacted]

Division of Enforcement

Securities & Exchange Commission

801 Cherry Street

Fort Worth, TX 76102

Phone: [redacted]

Fax: [redacted]

EXHIBIT 119

Unknown

From: Cohen, Jeffrey A.
Sent: Sunday, April 24, 2005 6:35 PM
To: Harold F. Degenhardt (b)(6), (b)(7)c @sec.gov); (b)(6), (b)(7)c (b)(6), (b)(7)c @sec.gov); (b)(6), (b)(7)c Preuitt, Julie A.; (b)(6), (b)(7)c (b)(6), (b)(7)c ; Stephen Korotash (b)(6), (b)(7)c @SEC.GOV); (b)(6), (b)(7)c @SEC.GOV); (b)(6), (b)(7)c (b)(6), (b)(7)c (b)(6), (b)(7)c

Attachments: Spence-toast.doc

Spence-toast.doc
(37 KB)

What I handed to Spence on Friday night...too cowed to say aloud.

-- Jeff

Spence,

"In a nation of sheep, one brave man forms a majority" said Edward Abbey, sheep-sheering polemicist par excellence. Like you Spence, Abbey was a majority of one. His maxim helps explain the diminishment I feel on account of your leaving – the sense that there's one less fence to hold at bay the herd mentality's creeping encroachment. It hasn't helped that your office looks picked over by vultures; I can hardly bring myself to walk past it. More than the emptiness though, it's the silence there that's unsettling: the knowledge that only echoes remain of your "Vox Clamatis Deserto Bureaucratio," your voice that cried in the bureaucratic wilderness.

It wasn't eloquence you were after. Your lightning flash e-mails were like a force of nature: the electrostatic discharge of strong moral conviction, bestirred by updrafts of bureaucratic hot air to redress a surplus of agency stupidity. Like a spring shower, your anger was refreshing. Invariably, it was what we needed. It was better than mere eloquence: "The art of orally persuading fools that white is the color it appears to be, and which includes the gift of making any color appear white."

It would be easy to wish you well in your new career: your leaving us "high and dry" has made "well-wishers" of us all. The truth that's difficult to admit is that parting between partisans is never easy – not when, going forward, a line must be drawn with scant room for neutrality. My ambition here is different than that of a fawning encomiast: what Ambrose Bierce called "a special (but not particular) kind of liar." What I want to do is make you, and keep you, angry – angry enough to last a lifetime.

Edward Abbey, who was perpetually angry, said it best: "Love implies anger. The man who is angered by nothing cares about nothing." Your anger Spence was outsized, because your love for your job, and for our office, was outsized. It's something that the passionless plodders and pinched pedants will never understand. The day you lose your anger will be a darker day than last Thursday – your last at the Commission.

William Hazlitt, a man also famous for his prickliness, drove the point home in his essay *On Good Nature*:

> Principle is a passion for truth; an incorrigible attachment to a general proposition. Good nature is humanity that costs nothing. No good-natured man was ever martyr to a cause, in religion or politics. He has no idea of striving against the stream. He may become a good courtier and a loyal subject; and it is hard if he does not, for he has nothing to do in that case but to consult his ease, interest, and outward appearance. A good-natured man is utterly unfit for any situation or office in life that requires integrity, fortitude, or generosity – any sacrifice, except of opinion, or any exertion, but to please...He will not forego the smallest gratification to save the whole world.... He will assent to a falsehood with a leer of complacency, and applaud any atrocity that comes recommended in the garb of authority. He will betray his country to please a Minister, and sign the death-warrant of thousands of wretches, rather than forfeit the congenial smile, the well-known squeeze of the hand.... He is a slave to the will of others, a coward to their prejudices, a tool of their vices. Spleen is the soul of patriotism and of public good.

I came to Ft. Worth three years ago because of you Spence. I was "invested" in you. We had commonality of interest; I relied on your managerial efforts"; and we shared in the kudos inuring to the office. But you've breached our investment contract by leaving, and set yourself up for an enforcement recommendation. So I suggest a settlement: you are to preserve intact, however rich and successful you become, a few remnant sparks of your infamous impatience with pettiness and stupidity, with bullshit in every form and however served. And you must strive to live up to the legend you've become, at 801 Cherry, and, most definitely, in D.C. Proof of complacency, of moral indifference, will void, retroactively, this settlement, and by operation of law (if only it were true), return you to us for (our mutual) remediation.

EXHIBIT 120

Re: Stanford 4/25/2005 11:54:00 AM

From: Cohen, Jeffrey A.
To: [redacted]@SEC.GOV]

Now.

-----Original Message-----
From: [redacted]
Sent: Monday, April 25, 2005 10:48 AM
To: Cohen, Jeffrey A.
Cc: [redacted]
Subject: RE: Stanford

When can you meet?

-----Original Message-----
From: Cohen, Jeffrey A.
Sent: Sunday, April 24, 2005 10:34 PM
To: [redacted]
Subject: Stanford

Must discuss this case with both of you ASAP--critical.

Sent from my BlackBerry Wireless Handheld

EXHIBIT 121

Date Received by SEC: 4/19/2005 CTR 2009 Control Number: 13639

Date Referred to Enforcement:

Intake Source:

Intake Source Control Number: 4156

Communication Type:

○ Email ○ Letter ○ Fax ○ Phone ◉ Other

Complainant Contact Information

Last Name: (b)(6), (b)(7)c Middle Initial: (b)(6), (b)(7)c First Name: (b)(6), (b)(7)c

Address Field 1: (b)(6), (b)(7)c

Address Field 2: (b)(6), (b)(7)c

Address Field 3:

City: (b)(6), (b)(7)c State: (b)(6), (b)(7)c Zipcode:

Telephone: (b)(6), (b)(7)c Email:

Referral Type: Other

Primary Entity or Person Involved: STANFORD GROUP

Entity Type:

Complaint Re Line:

☐ Referred to other division or other agency Referred to:

☐ Referred to Examination Staff Office Referred To:

☐ Referred to Enforcement Staff Office Referred To: Miami

Office Contact:

Staff Referred To: Branch Chief: Staff Attorney: (b)(6), (b)(7)c

Date Referred: 4/19/2005

Intake Comments: Whistleblower referral from OSHA. No. 592. Complaintant alleges he was fired in reprisal for reporting illegal financial activities.

Status 30 Days After Referral (Specify date updated):

☐ Under Review

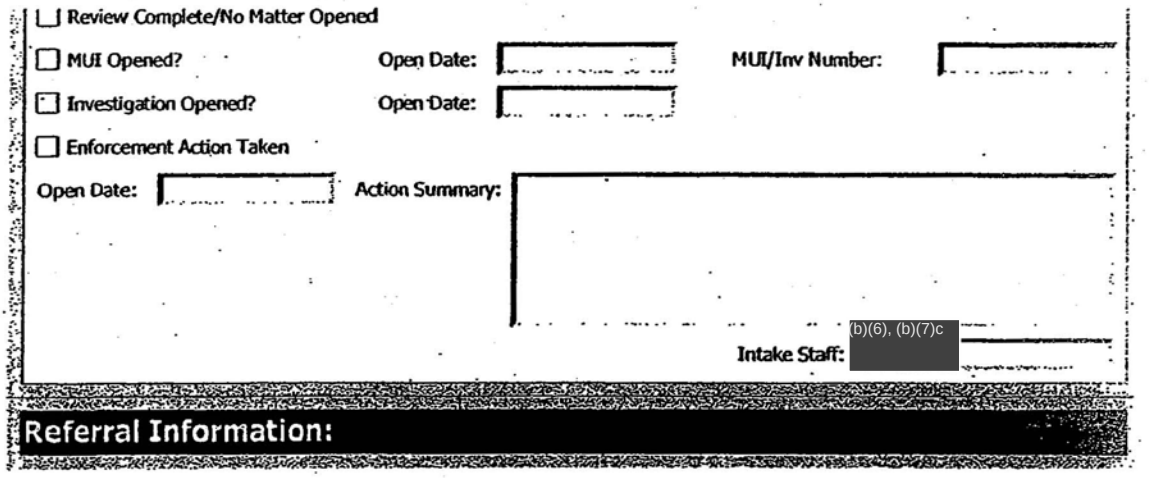
Review Complete/No Matter Opened
MUI Opened?
Open Date:
MUI/Inv Number:
Investigation Opened?
Open Date:
Enforcement Action Taken
Open Date:
Action Summary:
(b)(6), (b)(7)c
Intake Staff:
Referral Information:

EXHIBIT 122

Adler, Mark A.

From: Degenhardt, Harold F.
Sent: Tuesday, June 21, 2005 9:51 AM
To: (b)(6), (b)(7)c
Subject: RE: (b)(6), (b)(7)c -Stanford: S-Ox Section 806 Whistleblower Retaliation Claim

Thanks

From: (b)(6), (b)(7)c
Sent: Tuesday, June 21, 2005 8:52 AM
To: Degenhardt, Harold F.
Subject: (b)(6), (b)(7)c -Stanford: S-Ox Section 806 Whistleblower Retaliation Claim

You left me a note about this referral from the DOL (OSHA), asking how we handle referrals of this nature.

I think we ordinarily handle these as CTRs (complaint/tip/referral), by completing the usual form for entering the data into the CTR system. Whistleblower retaliation, which is the principal focus of the complaint, is not within our jurisdiction; and the referrals frequently don't contain any information about securities law violations that would justify follow-up by the enforcement staff. Accordingly, the most important thing is to have a record of our handling of these referrals, and the CTR system is the best tool for keeping such a record.

In rare cases, the referrals contain information that does justify follow-up, and this one appears to be an example of that. Stanford Group is a very problematic broker-dealer that has been the subject of enforcement investigations. (b)(6), (b)(7)c may be a valuable source of information about the firm. I'll make sure the information is available to the right person for that purpose, and I will also see that this gets into the CTR system.

THANKS

(b)(6), (b)(7)c
Division of Enforcement
Fort Worth Office
(b)(6), (b)(7)c

EXHIBIT 123

RE: Stanford

6/21/2005 8:56:00 AM

From: (b)(6), (b)(7)c
To: (b)(6), (b)(7)c @SEC.GOV]

We have an open investigation. (b)(6), (b)(7)c is the attorney assigned to the matter.

From: (b)(6), (b)(7)c
Sent: Tuesday, June 21, 2005 8:55 AM
To: (b)(6), (b)(7)c
Subject: Stanford

We just received, from the DOL (OSHA), a copy of a Sarbanes-Oxley whistleblower complaint about this firm. This may be what prompted them to try to retain Spence. Is there an open SEC investigation of the firm at this time? If not, we might want to open a MUI. This whistle blower may provide some valuable inside info on the firm that otherwise would be hard to get.

I have to run downstairs to a meeting, but I'll talk to you about this later.

THANKS

(b)(6), (b)(7)c

Division of Enforcement

Fort Worth Office

(b)(6), (b)(7)c

EXHIBIT 124

RE: Stanford Group Co. 6/14/2005 1:44:00 PM

From: (b)(6), (b)(7)c
To: (b)(6), (b)(7)c @SEC.GOV]

Let me know if you want to discuss how to respond.

From: (b)(6), (b)(7)c
Sent: Tuesday, June 14, 2005 12:37 PM
To: (b)(6), (b)(7)c
Subject: RE: Stanford Group Co.

I guess I could just change the heading to my letter to Antigua guy and make it a closing memo.

From: (b)(6), (b)(7)c
Sent: Tuesday, June 14, 2005 12:27 PM
To: (b)(6), (b)(7)c
Subject: RE: Stanford Group Co.

Apparently he hasn't seen your closing memo.

From: (b)(6), (b)(7)c
Sent: Tuesday, June 14, 2005 12:25 PM
To: (b)(6), (b)(7)c
Subject: FW: Stanford Group Co.

Uhhh----yeah.....we'll send a persuasive e-mail setting out why our case is so compelling....

From: (b)(6), (b)(7)c
Sent: Tuesday, June 14, 2005 11:59 AM
To: (b)(6), (b)(7)c
Cc: (b)(6), (b)(7)c
Subject: Stanford Group Co.

(b)(6), (b)(7)c –

I just got off the phone with Leroy King, Administrator of the International Financial Sector Regulatory Authority of Antigua. While the point of my calling him was to set up a conference call, he shared with me his belief that our letter was more innuendo than fact; that it wasn't clear that the conduct we were alleging was criminal; and that he wasn't clear what we wanted him to do (which is clearly identified in our letter under III.A.)

While this may sound discouraging, I explained to him that this matter had all of the hallmarks of a fraud – i.e., if it looks, walks and quacks like a duck, then ... – that we could say as much definitively once we had in our possession the bank records identified in III.A.

In the meantime, Mr. King needs more time evaluating our request. When I told him that there were individuals who believed that the money was being used to line the pockets of Mr. Robert Allen Stanford, he perked up and wanted to know as much about these individuals as possible.

At this point, I think that Mr. King could use a nudge in our direction. I think that it may not be a bad idea to send him a pithy email (with bullet points) explaining to him why our case is compelling, including the identities of those who would testify that Mr. Stanford is lining his pockets with investor money.

Other thoughts?

(b)(6), (b)(7)c

EXHIBIT 125

MINUTES

REGULATORY COORDINATION MEETING
Tuesday, June 21, 2005
Hosted by
SECURITIES AND EXCHANGE COMMISSION (FWDO)

Communication and Coordination

In FWDO, trying to fill Spence's position and also will be trying to fill (b)(6), (b)(7)c position.

Significant Exam findings

SEC

Hal Degenhardt

With change in Commission - more against individuals rather than companies.

(b)(6), (b)(7)c
(b)(5), (b)(7)a

IA/IC - Selling shares of IA to advisory clients
Failed to disclose disc. history and state of company - company is in ill health financially.

Mutual Fund Market Timing

1) (b)(5), (b)(7)a - working on settlement
2) (b)(5), (b)(7)a - charging independent directors - prospectus language misleading
3) (b)(5), (b)(7)a - Hedge Fund - traded through Southwest
4) (b)(5), (b)(7)a - Market Timing - allowed correspondent to do - working on settlement
5) (b)(5), (b)(7)a - $10 million - settled with firm, (b)(5), (b)(7)a still in litigation concerning Reps.

Performance Fee Cases

IA miscalculating fee charged to funds - working on settlements w/about 5 firms
(b)(5), (b)(7)a - sweep - entered into contract that fully disclosed mis-calculation & disclosure, used wrong period for calculation.
(b)(5), (b)(7)a - 529 College Savings Plan - working on settlement/penalty only but not disgorgement. They do not think this was deliberate. Different share classes involved.

Jeffrey Cohen

Stanford - Jeff not optimistic about viable enforcement referral
disclosure very cleverly crafted - impeccable for most part
investors well off, enjoying returns - no concrete evidence of Ponzi
Trying to reach out to some foreign investors for more information.

Calls it a CD when it's more like a hedge fund. Telling foreign investors there is no risk but American investors are being told there is complete risk. Moneys are being held in Stanford's Antiqua Bank. The fee is not disclosed to foreigners and to US they are not told fees are reoccurring. (b)(6), (b)(7)c to check with her Washington Enforcement Dept. about this.

(b)(6), (b)(7)c

Regulation IA - (b)(5), (b)(7)a

Marketed insurance investment product
Insured market investment against losses
2001 - he was advised not to add any more clients to policy but he continued to do so. (under investigation)
2003 - Insurance Co. (b)(5), (b)(7)a into receivership by Florida and continued to market it.
Our IA/IC team looking for other IA's that used (b)(5), (b)(7)a "Insured Principal cause Exam Sweep"

Formal Orders Received

(b)(5), (b)(7)a

Various Bond Offerings. Flying in various officials and their families

Periodic Payment Plans - Exams referred and accepted by Enforcement
Trying to determine whether to pursue.
NASD Enforcement in DC determined not to pursue
Feasible to do just suitability case?

Texas State Securities Board (TSSB)

(b)(6), (b)(7)c

(b)(5), (b)(7)a RR's trying to open IA - (b)(5), (b)(7)a

(NASD has ongoing investigation on (b)(5), (b)(7)a

Loophole under 504 - under state now must have investment intent (more specific language)

(b)(5), (b)(7)a - looking at sales reps. - Enron Bonds

(b)(5), (b)(7)a - working on settlement as part of national

(b)(5), (b)(7)a - looking at 200 to 300 Reps with periods of unregistered activity. Plans to suspend the firm and Reps and include fines. A laps in registration. Reluctant to cooperate with NASD. TSSB going back 5 years. If RR doesn't renew it automatically lapses (registration of Rep with state). They do not renew but continue to do business.

(b)(6), (b)(7)c

selling away from UBS. (b)(5), (b)(7)a

(b)(5), (b)(7)a - (b)(6), (b)(7)c acted as adviser to the issuer.

(b)(5), (b)(7)a - allowed RR's to use firm e-mail for personal use - no procedure to review - just took RR's words that not using it that way. RR's using LB e-mail to sell shares of (b)(5), (b)(7)a

(b)(5), (b)(7)a - Lots of unregistered branch offices

(b)(5), (b)(7)a - (b)(6), (b)(7)c - producing BOM in Houston - client on deathbed, wife instructs transfer (without authority) of $ out of his account into her own account. She was step-mom, kids were executors of will. She transferred to bank account with right of survivorship so she got $ instead of his kids under will.

(b)(6), (b)(7)c (b)(5), (b)(7)a - Selling away

now have 2 more - (b)(5), (b)(7)a another with selling away issues that work for (b)(5), (b)(7)a State is going to take a really close look at these.

www.ssb.state.tx.us

Hugh Wright - IF WE GET RESPONSE FROM COUNSEL INSTEAD OF FIRM - SEND BACK IMMEDIATELY! WE MUST HAVE RESPONSE FROM FIRM.

(b)(6), (b)(7)c **- Oklahoma**

(b)(5), (b)(7)a - w/NASD New Orleans

(b)(5), (b)(7)a - Tulsa - churned elderly alztimer patient customers - est. own unregistered IA - charged excessive fees too! - Lack of supervision - 83 agents that are off sight. 75 of them have never been visited. One compliance officer over 83 agents. 30-40 have email on business cards even though firm does not allow (but they approved the business cards).

(b)(5), (b)(7)a - Shawnee Branch - very aggressively marketing VA's other branches (1-2) same thing.

(b)(5), (b)(7)a - 3 in Oklahoma, 2 in Texas - TC's showing conversion of funds related to insurance premiums. Mis-appropriation of Insurance Premiums.

(b)(5), (b)(7)a - A motion to dismiss has been filed and hearing for this will be July 8, 2005. 30 have come forward and paid back - others have hired lawyers to argue that state can not ask for it back. IRS is looking into this also. (b)(6), (b)(7)c has agreed to 10 years on Federal Charges. Charged with just under $10 million.

(b)(6), (b)(7)c **- NASD**

(b)(5), (b)(7)a (New Orleans did exam) - about to go formal

Free-riding, Reg T

clear through (b)(5), (b)(7)a - highlighted weaknesses at (b)(5), (b)(7)a

(NASD sweep on Reg T - includes (b)(5), (b)(7)a

(b)(5), (b)(7)a - switching - completing review

New RR's brought in customer switched to new prop. Products.

(b)(5), (b)(7)a - working on settlement - directed comm.

found 2000 customer checks in safes, desk drawers, etc. Failed to forward checks. ($1 million fine)

(b)(5), (b)(7)a - Settlement talks.

(b)(6), (b)(7)c - divest ownership??

Looking at new proposed owner, do they meet standards for transfer.

2005 exam - just finished fieldwork. Markups, supervision, unauthorized trans.

(b)(5), (b)(7)a - (b)(6), (b)(7)c

Just signed AWC - fines, suspensions

Net capital issues - under 23 months.

(b)(5), (b)(7)a - hearing on (b)(6), (b)(7)c

(b)(5), (b)(7)a - settlements talk on (b)(5), (b)(7)a - Problem - separate side agreements to hide liabilities of correspondent firms.

(b)(5), (b)(7)a - B Shares - Referred to Enforcement on class B securities.

(b)(5), (b)(7)a - (b)(6), (b)(7)c - viatical settlements (was convicted in Florida)

How do you follow the $??

$40 million Ponzi - $ used to open (b)(5), (b)(7)a ??

Action against (b)(5), (b)(7)a - (b)(5), (b)(7)a - was president, out of his home

Looking to suspend (b)(5), (b)(7)a as a principal.

Julie Preuitt

Shelby's Office and GAO - Sweep on (b)(5), (b)(7)a.

(b)(5), (b)(7)a

Gathering information for Shelby & GAO.

(b)(5), (b)(7)a - Sales of VUL's & PPP's (Periodic Payment Plans

Trying to get a varible annuities case. (b)(6), (b)(7)c - divides to 8 different contracts.

Doesn't make sense! Not coming up on exception reports.

VA - Tulsa - (b)(5), (b)(7)a - Referred by (b)(6), (b)(7)c

Housekeeping

Oklahoma or Arkansas are to host the next Summit Meeting

June 21, 2005 **Summit Meeting**

Attendees	Organization
Julie Preuitt	SEC
(b)(6), (b)(7)c	Oklahoma
	SEC
Hugh M. Wright	SEC
(b)(6), (b)(7)c	NASD
Hal Degenhardt	SEC
(b)(6), (b)(7)c	SEC
Jeff Cohen	SEC
(b)(6), (b)(7)c	SEC
	TSSB
	SEC
Victoria Prescott	SEC

EXHIBIT 126

RE: Stanford: Options to obtain bank documents

7/11/2005 6:56:27 AM

From: Prescott, Victoria F.
To: [redacted]@SEC.GOV]

No problem. Hope your appointment goes well.

Victoria
[redacted]

-----Original Message-----
From: [redacted]
Sent: Sunday, July 10, 2005 7:53 PM
To: Prescott, Victoria F.
Cc: [redacted]
Subject: Re: Stanford: Options to obtain bank documents

Victoria, if it is not too much trouble, please handle it with [redacted] Friday, I was [redacted] I have a follow up appointment Monday at 10. Thus, I'll be un able to participate.

I feel strongly that we need to make voluntary request for docs from bank. If we don't and close case, and later Stanford implodes, we will look like fools if we didn't even request the relevant documents. As for MLAT, we probably should discuss further. Talked to FBI agent in Houston who was aware of Standford. [redacted] As for having [redacted] lean on Leroy King, can't hurt.

Sent from BlackBerry Wireless Handheld.

-----Original Message-----
From: Prescott, Victoria F. [redacted]
To: [redacted]
Sent: Fri Jul 08 18:30:52 2005
Subject: FW: Stanford: Options to obtain bank documents

[redacted]

Are you available? If not, I am.

Victoria
[redacted]

From: [redacted]
Sent: Friday, July 08, 2005 4:36 PM
To: [redacted]
Cc: [redacted]; Prescott, Victoria F.; [redacted]
Subject: Stanford: Options to obtain bank documents

[redacted] -

I want to confirm that we will call you @ 11:00 a.m. on Monday (July 11), regarding Stanford.

Separately, I want to relay to everyone a telephone call I had with (b)(6), (b)(7)c of the International Programs Unit of the Asset, Forfeiture, Money Laundering Section of the US Department of Justice. She had the following to say about Leroy King and Robert Stanford:

* Leroy King got his job because he had been recommended by Robert Stanford;

* While the new government is not enamored of Stanford; the old government was. Leroy King is a vestige of the old government;

* Stanford exerts considerable power in Antigua. He owns the newspaper, the land the airport sits on, a cricket club, a restaurant, etc. In short, he's the money guy.

The IRS attaché based in the US Embassy in Barbados is (b)(6), (b)(7)c). She interfaces with King on an almost daily basis (b)(6), (b)(7)c believes that (b)(6), (b)(7)c might be able to exert some power over King. A second option would be to ask for (on a voluntary basis) the documents directly from Stanford. (b)(6), (b)(7)c believes that this approach stands a chance of working because Stanford is trying to shed his image/stigma as a money launderer. According to (b)(6), (b)(7)c Stanford has cooperated on other occasions with law enforcement.

To recap, the following options exist to obtain the bank documents:

1. MLAT (Requires criminal interest, even soft interest, to make this request);

2. Ask (b)(6), (b)(7)c (the IRS attaché) to lean on Leroy King; and

3. Ask for the documents voluntarily from Stanford.

I will call (b)(6), (b)(7)c in advance of our phone call @11 a.m. on Monday and relay her views to the group.

Have a wonderful weekend!

(b)(6), (b)(7)c

EXHIBIT 127

Pages 119 through 123 redacted for the following reasons:
- -
(b)(7)e

EXHIBIT 128

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
BURNETT PLAZA, SUITE 1900
801 CHERRY STREET, UNIT #18
FORT WORTH, TEXAS 76102-6882
PHONE: (817) 978-3821 FAX: (817) 978-2700

IN REPLYING
PLEASE QUOTE

June 29, 2005

(b)(6), (b)(7)c

NASD District 6
12801 North Central Expressway, Suite 1050
Dallas, TX 75243

Dear (b)(6), (b)(7)c

As you requested in our phone conversation last week, I am writing to provide further information from our October 2004 examination of Stanford Group Company ("SCG"), a Commission-registered broker-dealer headquartered in Houston, Texas. SGC (#8-48611) has been registered with the Commission since October 25, 1995. The firm is wholly owned by Stanford Group Holdings, Inc., which is owned by Robert Allen Stanford.[1] SGC has approximately 110 registered representatives spread among its main office in Houston and 11 branch offices located throughout the U.S.[2] SGC's primary business is selling to its customers securities issued by its affiliate, Stanford International Bank ("SIB"). Of SGC's $41,000,000 in revenue for the eight months ended August, 2004, approximately $26,000,000 (or nearly 63%) are from concession payments for the sale of securities issued by SIB, which it markets as "certificates of deposit" ("CDs"). It also appears that most of SGC's CD sales are to foreign investors: as of October 2004, SGC customers held approximately $1.5 billion of CDs, of which approximately $227 million were held by U.S. investors.

[1] The Stanford Financial Group website (www.stanfordfinancialgroup.com) also lists numerous affiliates, including:

- Stanford Trust Company Limited ("STC"), located in Antigua, which offers trust services to investors;
- SIB, located in St. John's, Antigua, West Indies, which holds itself out as offering private banking services to international investors, including CDs and credit cards;
- Bank of Antigua, Limited appears to be a full service commercial bank that offers checking/savings accounts, CDs, credit cards and both personal and commercial loans;
- Stanford Development Corporation, which invests in real estate limited partnerships and oversees the design and construction of, and manages, Stanford offices;
- Stanford Development Company, Limited, which oversees the development of 60 acres surrounding Antigua's International Airport;
- Stanford Group Casa de Valores, S.A., a Ecuadorian broker-dealer with offices in Quito and Guayaquil; and
- Stanford Investment Advisory firms: Stanford Group Aruba N.V. in Aruba, Stanford Group (Suisse) AG in Zurich, Switzerland, Stanford Group (Antigua), Stanford Group Venezuela Asesores de Inversion, C.A. in Venezuela and Stanford Group Mexico, S.A. de C.V. in Mexico.

[2] SGC also has approximately 20 foreign associates located primarily in South and Central America.

SIB

SIB's disclosure documents state that its primary business is not to make loans, but rather to manage the deposits of its customers. SIB's annual financial statements suggest that virtually all customer deposits have been invested in its securities portfolios.[3] The Staff has made numerous efforts to obtain information about SIB through its examination of SGC. Despite the fact that SGC is generating as much as 63% of its revenue from the sale of securities issued by SIB, SGC claims that it keeps no records regarding the portfolios into which SIB places investor funds and that it can not get this information from SIB.[4] Indeed, SGC has related to the Staff that SIB claims it cannot divulge the specifics of how it has used customers' deposits, based (variously) upon the bank secrecy laws of Antigua and SIB's own internal "Chinese Wall" policies with SGC. SGC's admitted inability to get information from SIB about the investments underlying the CDs suggests that SGC may be violating NASD Rule 2310 (Suitability).

The "CD" Offering

SGC and SIB market the investment they offer and sell as a CD, which they claim is not a security and therefore, is not subject to the federal securities laws. We disagree.[5] In reality, the offerings are either an investment contract or interests in an unregistered investment company.

The offering brochure for each of the CDs promises investors a guaranteed minimum interest rate or return, as noted below.

- Fixed CD: minimum deposit of $10,000. Interest rates range from 4.25% for a three month term to 7.025% for a 60 month term. Moreover, should rates decrease during the term of the CD, customers are "guaranteed the original interest rate until maturity."
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- Index-Linked CD: minimum deposit of $50,000. Permits the investor to choose the greater of either "guaranteed minimum annualized yield" of 3.58% for a three year term; 3.65% for a four year term; and 3.71% for a five year term, or interest calculated based upon the increase of one of three indexes:
  - S&P 500—offering documents suggest a participation rate of 125%
  - Nasdaq 100—offering documents suggest a participation rate of 85%
  - DJ Stoxx 50—offering documents suggest a participation rate of 100%

Possible Fraudulent Scheme

The CDs being offered appear too good to be true. As noted, SIB claims it is investing in "foreign and U.S. investment grade bonds and securities, and Eurodollar and foreign currency deposits" and "securities from established, quality companies and governmental agencies from around the world." Yet, SIB's high interest rates are inconsistent with its claimed portfolio. Minimum guaranteed interest rates since 2000 have ranged from approximately 3.5% to over 6% for short-term investments. For the Index-Linked CD tied to the S&P 500, the minimum guarantee has been approximately 3.5% or a percentage of the return of the S&P 500, whichever is higher. The brochures given to investors indicate that that percentage of participation may vary at the SIB's discretion, but suggest a participation rate of ***125%*** of the S&P 500.[6] We are unaware of any legitimate short-term investment that not only guarantees a return significantly higher than a CD, but allows you to participate in up to 125% of equity market returns. Moreover, SIB's *annual* 3% trailer is also troubling, as it adds significant, on-going costs which SIB must meet before it can generate a profit. We are unaware of any legitimate, short-term, low or no-risk investments that will pay a 3% concession every year an investor keeps his funds invested in any product.[7]

Further, SIB's annual audit casts doubt upon its claims of consistent profitability over the last 20 years. For example, from 2000 through 2002, SIB reported earnings on investments of between approximately 12.4% and 13.3%.[8] This return seems remarkable when you consider that during this same time frame SIB supposedly invested at least 40% of its customers' assets into the global equity market. Ten of 12 global equity market indices were *down substantially* during the same time frame. The indices we reviewed were down by an average of 11.05% in 2000, 15.22% in 2001 and 25.87% in 2002. It is equally unlikely that the portion of the portfolio invested into debt instruments (approximately 60%) could make up the expected losses in the

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[8] This extrapolation is based upon two premises. First, that the year end revenues were generated from returns on SIB's portfolio, and that customer deposits were the exclusive source funding the portfolio. Second, that customer deposits remained constant throughout the year—assuming, *arguendo*, that investor deposits increased during the year (as we believe) the extrapolated rate of return would be even higher.

equity portion of the portfolio. For example, in 2002, when the global indices were down 25%, the debt portion of the portfolio would have to generate an approximately 40% return for SIB to generate the 12.4% overall return it claimed in 2002.

Finally, the Staff learned from persons formerly associated with SGC that it also appears to be engaged in sales practices that are commonly associated with fraudulent activities. The firm pushes its RRs to sell the CDs by engaging in aggressive sales contests. Prizes offered include trips to Antigua and automobiles. One RR has stated that she was fired for her refusal to sell SIB CDs. Moreover, the SGC has refused to provide to the selling RRs any further disclosure other than the minimal information it provides to potential investors regarding the specifics of SIB's investment portfolio.

Possible Misrepresentations/Omissions

SIB and SGC's secrecy about how customer funds are invested is a matter of significant concern. Not only do SIB's purported returns seem unrealistic, but also former associated persons have reported that they suspect that investment funds are being diverted to underwrite Allan Stanford's burgeoning real estate and construction interests on Antigua and in Central and South America. In an effort to quell its concerns, the Staff requested information from SGC concerning how funds entrusted to it by customers are invested. In response, SGC claimed that even it did not have access to this information, raising a significant issue with respect to its ability to comply with NASD Rule 3010.

SGC provides prospective U.S. *and* foreign customers a short, user-friendly glossy sales brochure that provides no information about how funds are invested and contains no risk disclosure. These brochures portray the offering as a CD and emphasize safety along with a minimum interest rate or return. For example, these sales brochures refer to a "guaranteed" interest rate or a "Guaranteed Minimum Annualized Yield" and claim that the CD "provides a secure way" to participate in the growth of equity markets because it will pay the greater of a minimum guaranteed return or a return based on the increase in equity markets.

SIB's primary disclosure document is a 20 page "Disclosure Statement," which SGC provides *only* to its customers who are U.S. citizens. The Disclosure Statement makes only vague references to how SIB invests funds entrusted to it. For example, it states that SIB invests in a "global portfolio" which includes "foreign and U.S. investment grade bonds and securities" and that their investment portfolio consists of securities from established, quality companies and governmental agencies from around the world," equities, bonds, government bonds (foreign and domestic), and precious metals.

The Disclosure Statement is slightly more informative with respect to risk, acknowledging that the investment is not insured and involves substantial risk. It also notes that the entire investment could be lost and that returns are contingent upon returns on SIB's investment portfolios. However, this risk disclosure is juxtaposed with assurances that funds are invested in seemingly conservative portfolios, such as foreign and U.S. investment grade bonds and securities, and charts reflecting SIB's significant operating profits between 1990 and 2000.

Foreign customers, however, do not receive this Disclosure Statement. Instead SGC gives its foreign customers an "International Private Banking" brochure. This document discloses that SIB uses a global investment strategy to minimize exposure to any one regional market; that SIB has been consistently profitable; that over the past decade its CDs outperformed U.S. bank CDs by any average of 4.6%.; and that SIB strives for the highest degree of liquidity as a protective factor...assets are invested in a well-diversified portfolio of highly marketable securities issued by stable governments, strong multinational companies and major international banks."

Significantly, no disclosure is given to foreign investors regarding the 3% trailer paid to SGC. The materials for U.S. investors note that there is a referral fee of as much as 3%. Given that the CDs are securities and SCG is participating in the distribution of the CDs, pursuant to Exchange Act Rule 10b-10(2)(D), SCG is required to disclose the source and amount of remuneration it received in connection with the transaction. Therefore, it appears that the absence of any disclosure to foreign investors violates Rule 10b-10, and that the disclosure to U.S. customers may be deficient.

Sincerely,

Victoria F. Prescott
Senior Special Counsel
Fort Worth Office

Enclosures: as noted

CC: Hugh M. Wright, Associate District Administrator
Julie A. Preuitt, Assistant District Administrator

EXHIBIT 129

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
BURNETT PLAZA, SUITE 1900
801 CHERRY STREET, UNIT #18
FORT WORTH, TEXAS 76102-6882
PHONE: (817) 978-3821 FAX: (817) 978-2700

IN REPLYING
PLEASE QUOTE

July 21, 2005

(b)(6), (b)(7)c

NASD District 6
12801 North Central Expressway, Suite 1050
Dallas, TX 75243

Dear (b)(6), (b)(7)c

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Significantly, no disclosure is given to foreign investors regarding the 3% trailer paid to SGC. The materials for U.S. investors note that there is a referral fee of as much as 3%, but fails to explain that the referral fee is ongoing in nature. Given that the CDs are securities and SCG is participating in the distribution of the CDs, pursuant to Exchange Act Rule 10b-10(2)(D), SCG is required to disclose the source and amount of remuneration it received in connection with the transaction. Therefore, it appears that the absence of any disclosure to foreign investors violates Rule 10b-10, and that the disclosure to U.S. customers may be deficient.

Sincerely,

Victoria F. Prescott
Senior Special Counsel
Fort Worth District Office

CC: Hugh M. Wright, Associate District Administrator
Julie A. Preuitt, Assistant District Administrator

EXHIBIT 130

REPORT OF THE 2009 SPECIAL REVIEW COMMITTEE ON FINRA'S EXAMINATION PROGRAM IN LIGHT OF THE STANFORD AND MADOFF SCHEMES

SEPTEMBER 2009

SPECIAL REVIEW COMMITTEE

Charles A. Bowsher (Chairman)

Ellyn L. Brown

Harvey J. Goldschmid

Joel Seligman

INDUSTRY GOVERNOR ADVISERS
Mari Buechner
W. Dennis Ferguson
G. Donald Steel

OF COUNSEL
Paul V. Gerlach
Griffith L. Green
Dennis C. Hensley
Michael A. Nemeroff
SIDLEY AUSTIN LLP
1501 K Street, NW
Washington, DC 20005

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I. EXECUTIVE SUMMARY

On April 13, 2009, the Board of Governors ("Board") of the Financial Industry Regulatory Authority, Inc. ("FINRA") established a Special Review Committee ("Special Committee")[1] to review FINRA's examination program, with particular emphasis on the examinations of FINRA member firms associated with R. Allen Stanford and Bernard L. Madoff. The Board was particularly concerned by the significant harm to investors caused by Stanford and Madoff. Pursuant to a resolution approved by the Board, the Special Committee was asked to "recommend . . . changes in the examination program, where appropriate, to improve member oversight and FINRA's fraud detection capability," and to consider management's "monitoring [of] compliance with examination program policies."[2]

The Special Committee, acting through outside counsel, reviewed relevant examination files from 2003 to 2009 of the principal member firms associated with Stanford and Madoff. Interviews were conducted with the examiners, supervisors, and managers still employed by FINRA who were involved in the examinations. In addition, outside counsel interviewed numerous headquarters staff and senior management to enable the Special Committee to develop factual findings and recommendations.[3] In total, outside counsel conducted 60 interviews of FINRA staff. Because of ongoing civil and criminal actions involving the Stanford and Madoff schemes, counsel did not interview persons other than current FINRA employees or obtain information directly from the implicated firms or from the Securities and Exchange Commission ("SEC").

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[1] All members of the Special Committee are public governors of FINRA.

[2] The Charter of the Special Committee is attached as Appendix A to this report. In making its recommendations regarding FINRA's examination program, the Special Committee was not asked to comment on personnel matters.

[3] The Special Committee solicited the input of FINRA senior executive staff prior to finalizing the recommendations presented in this report.

The Ponzi schemes allegedly perpetrated by Stanford and admitted to by Madoff are striking because of their size and duration.[4] Madoff's scheme spanned decades, defrauded thousands of investors, and caused an estimated $64 billion in investor losses. According to the SEC, Stanford sold numerous investors approximately $7.2 billion of fraudulent products, purported to be certificates of deposit ("CDs"), over at least a decade.

FINRA's examinations of the Madoff and Stanford firms did not uncover these frauds. The histories of the examinations of these firms present distinct lessons for improving FINRA's examination program.

A. The Stanford Case

Between 2003 and 2005, the National Association of Securities Dealers—FINRA's predecessor entity—received credible information from at least five different sources claiming that the Stanford CDs were a potential fraud. The most striking was a July 2005 five-page referral letter from the SEC's Fort Worth office that explained in detail why the purported investment strategy of the offshore bank could not have produced the consistently high returns being paid by the CDs. The letter stated that the CD program was a "possible fraudulent scheme" and that the returns were "too good to be true." According to this letter, "as of October 2004, [the Stanford firm's] customers held approximately $1.5 billion of CDs." Despite the existence of this "red flag" and others described in the body of this report, FINRA did not launch an investigation of whether the Stanford CD program was a fraud until January 2008.[5] By the time the CD program was shut down by the SEC in February 2009, the alleged amount of

[4] Bernard Madoff has confessed and pled guilty. As of the publication of this report, Allen Stanford is contesting the charges against him.

[5] As discussed in the body of the report, FINRA's 2005 cause examination did result in a charge against the Stanford firm for advertising violations relating to the CD program and a $10,000 fine.

investor funds had grown to approximately $7.2 billion. According to the court appointed receiver in the Stanford matter, the vast majority of these funds will never be recovered.

FINRA missed a number of opportunities to investigate the Stanford firm's role in the CD scheme. First, FINRA's Dallas office staff curtailed a 2005 investigation prompted by the SEC referral letter because of a concern that the offshore CDs were not "securities" regulated under federal securities laws. Facts surrounding the decision not to pursue the fraud investigation indicate that certain of FINRA's examination staff were then, and may remain, unsure of the full scope of the organization's investigative authority, are reluctant to pursue investigations where jurisdiction questions arise, and are not adequately trained to identify alternate bases of jurisdiction.

Second, although the CD program involved billions of dollars of investor funds, FINRA procedures, at the time and now, do not set forth criteria for escalation of a matter to senior management or the use of specially-trained investigators based on the gravity and substance of the fraud allegations. The Dallas staff did not provide the SEC referral letter to senior management in Washington, DC, until December 2008.

Third, FINRA's member examination program focuses the majority of member regulation resources on routine "cycle" exams. Although SEC-required cycle exams play a role in ensuring that member firms are adequately capitalized and compliant with regulatory requirements, they are not an effective means for uncovering complex frauds such as the alleged CD scheme.

Fourth, FINRA's Dallas staff did not adequately document communications with the SEC, or discussions within FINRA itself, regarding the CD program. As a result, critical

decisions regarding the course of examinations were influenced by misunderstandings and incomplete exchanges of information.

Finally, FINRA did not—and still does not—have a centralized database that gives examiners direct, electronic access to all relevant complaints and referrals associated with a member firm. As a result, no single FINRA staff member was ever aware of all of the "red flags" related to the Stanford firm that are discussed in this report.

The Special Committee recommends that FINRA's examination program should be revamped to ensure that fraud detection and prevention are core elements. This is particularly critical when the potential fraud poses risk of significant harm to investors. Allegations of the magnitude and gravity of those in the Stanford case should be given the highest priority, immediately escalated to FINRA senior management, and vigorously pursued by well-trained FINRA staff with all necessary investigative tools and techniques. The Special Committee agrees with and supports the plan of FINRA senior management to create a dedicated fraud detection unit. The Special Committee believes the unit should centrally manage fraud cases involving potentially significant investor losses and ensure that cause exams involving significant allegations of fraud receive the highest priority in terms of staffing and resources.

B. The Madoff Case

The Madoff case provides a different perspective on FINRA's examination program. In contrast to the Stanford matter, the Special Committee did not find evidence that FINRA received any whistleblower complaints regarding the Madoff scheme or that the SEC shared any concerns or specific allegations about Madoff with FINRA prior to the time when Madoff admitted his fraud. Indeed, the broker-dealer records provided to FINRA contained no indication that the Madoff firm was operating an investment advisory business. Madoff maintained separate bank accounts, cordoned off the investment advisory business to a separate

floor of his firm's office space, and deliberately failed to disclose his investment advisory activity in broker-dealer forms submitted to FINRA.

In 2006, the SEC caused the Madoff firm to register as an investment adviser and to submit information on its advisory business to the Investment Adviser Registration Depository ("IARD"), a system operated by FINRA pursuant to a contract with the SEC. The Madoff firm continued to represent to FINRA that it was not involved in investment advisory activity, and—more generally—that it did not maintain any customer accounts. FINRA examiners did not have direct access to the Madoff firm's IARD entries.

In the course of their cycle examinations, FINRA examiners did come across several facts worthy of inquiry associated with the Madoff scheme that, with the benefit of hindsight, should have been pursued. Most notably, in the course of examining a related firm—Cohmad Securities Corporation[6]—that brought investors into the Madoff Ponzi scheme, FINRA staff observed records of substantial, recurring payments from the Madoff firm to Cohmad. In addition, in a 2007 examination of the Madoff firm, FINRA staff uncovered commissions from a London affiliate that now appear to have served as a money laundering operation for Madoff's investment advisory business. If FINRA's examiners had fully investigated these transactions, it is possible that they would have developed suspicions and investigated further regarding Madoff's business.

In the final analysis, however, the most notable fact about the Madoff case is that FINRA's ability to effectively examine firms registered as both broker-dealers and investment advisers would be greatly enhanced if FINRA had jurisdiction to enforce the requirements of the

[6] As explained in the report, Cohmad was partially owned by Madoff and was located in the offices of the Madoff firm. On June 22, 2009, the SEC filed a lawsuit against Cohmad accusing it and its principals of "participating in Bernard L. Madoff's Ponzi scheme by raising billions of dollars from hundreds of investors under a shroud of secrecy." Complaint in *SEC v. Cohmad Securities Corp. et al.*, S.D.N.Y. 09 Civ. 5680.

Investment Advisers Act of 1940 ("Investment Advisers Act"). This additional jurisdiction would enable FINRA to be more effective in detecting fraud in both broker-dealers and investment advisers. In addition, to uncover frauds such as that perpetrated by Madoff, FINRA must amend and improve its examination process and examiner training. The Madoff case underscores the need for FINRA's examination program to develop means to verify independently the data submitted by member firms. At present, cycle exams principally rely on the representations of member firms, and, thus, are heavily dependent on the honesty and completeness of the member firm's response. The Madoff case also highlights the need to improve the exchange of information within FINRA and between the SEC and FINRA, including the sharing of information about potentially fraudulent conduct at member firms. Finally, the Madoff case demonstrates the need for FINRA to clarify the extent of its jurisdiction, and to more aggressively exercise that jurisdiction.

C. Recommendations

The issues identified above and further described in this report are the basis for the recommendations of the Special Committee. The recommendations are described in detail in this report at pages 71-76. Virtually all of these recommendations will require FINRA management and the Board to make key decisions on resource allocations. Some of these recommendations will require action by the SEC or Congress. The most important of these recommendations include:

FINRA should clarify and expand its jurisdiction to enable it to be more effective in detecting fraud and protecting investors. FINRA is fundamentally hampered by its lack of jurisdiction over investment advisory activities. FINRA should proactively seek new jurisdiction from Congress to regulate activities under the Investment Advisers Act to give it more effective means to detect future Madoff-like situations. FINRA also should clarify its current jurisdiction

to regulate member firms and associated persons and more aggressively seek information, especially where there are indications of fraud. FINRA should expand its jurisdiction to enable it to obtain information from affiliates of member firms in its enforcement of the Securities Exchange Act of 1934 and FINRA rules when it believes there is evidence of fraud.

FINRA should restructure its examination program to make fraud detection a core element. The Special Committee supports FINRA management's plan to create a dedicated fraud detection unit. Examinations should be prioritized to expedite any investigation involving potential fraud, serious harm to investors, or continuing serious misconduct. This restructuring should strengthen the cause examination program and revise the cycle examination program. In taking these steps to improve its examination program, FINRA will need to make greater use of personnel with specialized skills and improve its internal exam-related procedures. In particular, FINRA should improve its documentation of legal and regulatory issues, including its internal communications and communications with other regulators.

FINRA should improve the technology available to its examination staff, enhancing systems and access so that examiners are empowered to easily locate and analyze all data and documents within FINRA regarding a member firm. Such tools could have significantly improved the staff's ability to grasp the pattern of complaints against Stanford.

FINRA should end its virtual total reliance on data provided by member firms. FINRA should adopt procedures to test and confirm certain member-provided data against third-party sources such as independent auditors and non-affiliated banks. FINRA also should cross-check data provided to FINRA in various submissions by the same firm. Third-party verification and cross-checking could have provided examiners additional means to uncover the Madoff fraud.

FINRA should work with the SEC and other regulators to expand FINRA's access to and use of available data about member firms and their associated persons. Such data sharing will assist FINRA in obtaining more complete information on those that it regulates. FINRA also should enhance its training program for the examination staff, focusing on fraud training and requiring formal continuing education and training.

The Special Committee believes the recommendations above should be implemented by means of a Plan of Action developed by FINRA management and presented for consideration by the Board. Management has agreed to present a Plan of Action for approval or ratification at the December 2009 Board meeting.

II. BACKGROUND ON FINRA EXAMINATION PROGRAM

FINRA is a non-governmental, self-regulatory organization subject to SEC oversight under Section 15A of the Securities Exchange Act of 1934 ("Exchange Act"). It was created in 2007 through the merger of the National Association of Securities Dealers ("NASD") and the member regulation, enforcement, and arbitration functions of New York Stock Exchange Regulation, Inc. ("NYSE"). It is responsible for overseeing broker-dealers, who must register with the SEC and become members of FINRA, and registered representatives, who must pass examinations demonstrating their knowledge and expertise. As of December 31, 2008, there were 4,895 broker-dealers and 664,975 registered representatives subject to FINRA's oversight. FINRA also engages in oversight of various securities markets and facilities. FINRA has approximately 2,800 employees and operates from Washington, DC, and New York, NY, as well as from 15 district offices around the nation.

FINRA has an active enforcement program designed to promote compliance with the Exchange Act and FINRA rules. In each year between 2004 and 2008, FINRA and its predecessors, NASD and NYSE, expelled an average of 21 firms and banned an average of 433 registered representatives from the industry. In each of these years, FINRA also suspended 396 registered representatives, collected approximately $97.4 million in fines, and obtained restitution for broker-dealer customers amounting to $105 million on average. In 2008, the settlement of its auction-rate securities cases returned $1.172 billion to investors. Each year FINRA receives about 25,000 complaints, tips, and similar items, which are processed by an organization called Central Review Group-Front End Cause. This organization handles about 20,000 of these items and refers the remaining 5,000 to district offices for processing.

FINRA's examination program is presently organized into two basic departments: Member Regulation and Market Regulation. Market Regulation, the smaller of the two departments, is not considered in this report because its responsibilities are not relevant to the Stanford and Madoff schemes.

The Member Regulation department is charged with oversight of FINRA member firms and is subdivided into Sales Practice, Risk Oversight and Operational Regulation ("Risk Oversight"), and Shared Services. Sales Practice is the largest of these three groups. It is charged with the oversight of about 4,800 member firms. It had about 560 examiners and 106 supervisors as of December 31, 2008, located in 15 district offices across the United States. The examiners are supported by enforcement lawyers also located in the district offices who report separately to the Enforcement department.

Sales Practice is responsible for conducting onsite examinations of financial operations and sales practices—called "cycle exams"—as well as "cause exams," which stem from customer complaints, anonymous tips, referrals from the SEC and other sources. Sales Practice conducts more that 2,100 cycle exams each year. Sales Practice's policy is to complete all cycle exams each year, although this goal is not always met. Firms are scheduled for cycle examinations every year, every two years, or every four years based on an annual risk assessment that incorporates numerous factors. Firms judged to be the most prone to regulatory concerns are examined each year. Sales Practice district offices also complete about 5,000 cause examinations each year.

Risk Oversight is responsible for overseeing the financial solvency of approximately 500 of the largest FINRA member firms and those with the most complex operations. For example, almost all clearing and carrying firms are examined by Risk Oversight. Risk Oversight

also is assigned large proprietary trading firms with over $100 million in annual revenues. The Madoff firm was scheduled to be examined by Risk Oversight in March 2009, but this exam was obviated by Madoff's confession. Most firms examined by Risk Oversight are located in the New York metropolitan area, and most of the subdivision's 140-person examination staff is located in its office in New York City.

Shared Services is primarily responsible for planning the annual cycle examination program and for developing policies that control both cycle and cause examinations. This includes detailed monitoring and budgeting of examination hours. Shared Services also is responsible for the quality assurance program, Sales Practice policies, training for Sales Practice examiners and other staff, and the administration of Member Regulation.

Prior to FINRA's formation in 2006, the member firms associated with Stanford and Madoff that are discussed in this report were members of NASD. For ease of reference, except where otherwise noted, this report generally refers to both NASD and FINRA as "FINRA."

III. EXAMINATIONS OF MEMBER FIRMS INVOLVED IN THE STANFORD AND MADOFF SCANDALS

A. The Stanford Case

1. Background

According to civil and criminal actions brought in 2009 by the SEC and the United States Department of Justice, respectively, R. Allen Stanford ("Stanford") and his closest associates have engaged in a massive and long-running fraudulent scheme. Acting through a series of companies under their control, Stanford and his co-defendants are alleged to have sold financial products, purported to be CDs, and to have diverted investors' funds to illiquid, high-risk investments. As evidenced by sales brochures provided to FINRA and the SEC, the Stanford companies issuing and marketing the CDs represented to investors that their money was being placed in safe and liquid investments. These companies also claimed consistent double digit rates of return for the purported CDs. According to allegations in the SEC's case against Stanford, the claimed rates of return were virtually impossible under the Stanford bank's stated investment strategy, and were fabricated out of whole cloth by Stanford and his co-defendants. The defendants allegedly defrauded investors of approximately $7.2 billion.

The purported CDs, issued by Stanford International Bank, Ltd. ("the Stanford bank"),[7] were marketed by, among other entities, Stanford Group Company ("the Stanford firm"), a Houston-based company with numerous offices in the United States. The Stanford firm was established in 1995, registered with the SEC as a broker-dealer, and became a member of FINRA. As a FINRA member, the Stanford firm was subject to periodic cycle and cause exams. Because the firm's home office is located in Texas, many of these exams were conducted by

[7] The Stanford bank was founded in Montserrat and, since 1985, has been based in Antigua and Barbuda ("Antigua").

FINRA's Dallas office.[8] Between 2003 and 2008, commissions from the sales of offshore CDs constituted from 38 to 68 percent of the Stanford firm's total revenues reported to FINRA.[9]

2. Daniel Arbitration and 2003 Cycle Examination

In June 2003, a FINRA arbitration took place between the Stanford firm and Gregory Daniel, a former employee of the firm. Mr. Daniel alleged that he was wrongfully terminated, that he "was pressured to direct [his] clients[']' assets to the off shore bank in Antigua," and that he was forced to sell "proprietary managed money products with no track record, cash inflows or clear investment objective." The arbitration concluded in a settlement between the parties, but the arbitrators referred the matter to FINRA's Enforcement department in August 2003 for investigation of possible rule violations by the firm or, alternately, possible abuse of the arbitration process by Daniel.

FINRA's Enforcement department, in November 2003, referred the Daniel matter to the then-Associate Director of the Dallas office, "for your review and whatever action you deem appropriate." According to email records from 2003, the Associate Director informed the examiners involved in the 2003 cycle exam of the Stanford firm about the allegations raised by Daniel. When interviewed, however, neither the Associate Director nor the Dallas Director recalled inquiring about the disposition of the Daniel arbitration referral until 2009, when news

[8] FINRA's Dallas office is a long-standing NASD-legacy office. From 1999 to 2003, the office was headed by Bernerd Young. In 2003, Young was replaced. The new Dallas Director implemented new procedures to increase both productivity and the diligence of examiners. Witnesses noted that Young's departure and the changes implemented by the new Director precipitated a significant change in personnel within the Dallas office—approximately half of the staff, including many examiners and exam managers, resigned their positions shortly after Young left. The office remained understaffed for some period of time. Witnesses noted that, by 2005, the staffing situation stabilized due to new hires and transfers from other FINRA offices.

After serving for a period of time as a securities industry consultant, Young was hired as the Managing Director of Compliance for the Stanford firm in June 2006, a position he held through 2009. The interviews of current FINRA employees and review of exam files identified no information to suggest that Young's presence at the firm compromised FINRA's subsequent examinations of the firm discussed in this report.

[9] These commissions are reported in FINRA's cycle exam reports of the Stanford firm under the heading "Solicitor of time deposits in a financial institution."

of the Stanford scandal broke and the Dallas Director sought to identify all files related to the firm.

The 2003 cycle exam of the Stanford firm was completed on December 15, 2003. The exam file contains no indication that Daniel was contacted by anyone on the exam team to determine what he knew about the CDs, or that FINRA took any action against the firm based on Daniel's allegations. The 2003 exam report indicated that 68 percent of the firm's revenues were generated from commissions from the sale of Stanford bank CDs. The 2003 exam file does not indicate that any of the examiners questioned the Stanford firm about the fact that it generated upwards of two thirds of its total revenue from the sale of these CDs.

3. 2003 Anonymous Tip Letter

In September 2003, FINRA received an anonymous letter describing an ongoing fraud within Stanford's business empire. The author claimed to be an insider. In bold capital font, the letter stated that Stanford Financial Group, the parent company of the Stanford bank and firm, **"IS THE SUBJECT OF A LINGERING CORPORATE FRAUD SCANDAL PERPETUATED AS A 'MASSIVE PONZI SCHEME' THAT WILL DESTROY THE LIFE SAVINGS OF MANY, DAMAGE THE REPUTATION OF ALL ASSOCIATED PARTIES, RIDICULE SECURITIES AND BANKING AUTHORITIES, AND SHAME THE UNITED STATES OF AMERICA."** The letter continues as follows:

> The Stanford Financial Group of Houston, Texas has been selling to the people of the United States and Latin America, offshore certificates of deposit issued by Stanford International Bank, a wholly owned unregulated subsidiary. With the mask of a regulated US Corporation and by association with Wall Street giant Bear Stearns, investors are led to believe these CD's are absolutely safe investments. Not withstanding this promise, investor proceeds are being directed into speculative investments like stocks, options, futures, currencies, real estate, and unsecured loans.

> For the past seventeen years or so, Stanford International Bank has reported to clients in perfect format and beautifully printed material of the highest quality, consistent high returns on the bank's portfolio, with never a down year, regardless of the volatile nature of the investments. By showing these unbelievable returns, Stanford has justified the expense spent on luxury, lavish styles of management, high bonuses, and generous contributions to all sorts of causes.
>
> The questionable activities of the bank have been covered up by an apparent clean operation of a US Broker-Dealer affiliate with offices in Houston, Miami, and other cities that clears through Bear Stearns Securities Corporation. Registered Representatives of the firm, as well as many unregistered representatives that office within the B-D, are unreasonably pressured into selling the CD's. Solicitation of these high risk offshore securities occurs from the United States and investors are misled about the true nature of the securities.
>
> The offshore bank has never been audited by a large reputable accounting firm, and Stanford has never shown verifiable portfolio appraisals. The bank portfolio is invested primarily in high risk securities, which is not congruent with the nature of safe CD investments promised to clients.

A copy of the Stanford bank's annual financial statement was attached to the letter, which also described Stanford's close association with Antigua, and referenced certain investigations and press articles suggesting that Stanford had engaged in bribery and money laundering. The letter concluded by urging regulators to focus on the "real market value" of the Stanford bank's investment portfolio, "*which is believed to be significantly below the bank's obligations.*" (Emphasis in original.) A carbon copy notation indicated that, in addition to FINRA, copies of the letter were sent to the SEC, a U.S. Senate Committee, the Office of the Comptroller of the Currency, and various media outlets.

The anonymous letter was processed by FINRA's Central Review Group-Front End Cause department in Washington, DC.[10] An analyst in that department determined that FINRA lacked jurisdiction over the matter, and referred the letter to the SEC. When interviewed, the analyst explained that he had concluded that FINRA lacked jurisdiction because he had been

[10] At the time, the department was known simply as "Front End Cause."

instructed, as part of his training, that CDs generally were not "securities" as defined under the Exchange Act. In reaching this determination, the analyst did not focus on the offshore nature of the Stanford bank's CD program, nor did he consider alternate bases of FINRA jurisdiction. The conclusion whether an offshore CD will be considered a security is not self-evident and depends, in large part, on the specific protections provided by the regulatory system in the jurisdiction in which the product is issued.[11]

The analyst wrote a short description of his handling of the matter in FINRA's internal electronic records database (in 2003, known as "MERIT"; now known as "STAR"). The description notes that "Product listed is 'offshore CDs' and Certificates of Deposit" and that the investigation concluded with "No Juris[diction]. Referred to SEC, 10/20/2003." This comment is the only substantive description regarding the Front End Cause investigation that anyone in the Dallas office would have seen when searching for files related to the Stanford firm in the MERIT or STAR databases. The MERIT and STAR databases did not contain a copy of the anonymous insider letter, although staff would have seen a reference to the letter and could have obtained a copy from the office where the entry was made.[12]

In her interview, the Dallas Director noted that her staff typically consulted the STAR database in preparing for an upcoming exam, but that, after seeing an entry finding no

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[11] For a discussion of the SEC's position that the Stanford CD are "securities," see pages 24-25 and footnote 52 below.

[12] STAR is a matter tracking system used by FINRA to track investigations, examinations, alerts, sweeps, reviews, referrals, membership applications, filings, disclosures, tips and complaints. The primary users of STAR are FINRA's Enforcement, Market Regulation and Member Regulation departments. Advertising and Corporate Finance also track matters in STAR. Departments such as Office of Disciplinary Affairs, Registration and Disclosure and Finance update matters in STAR as well with information relevant to their business practices.

Numerous matter-related data elements are tracked in STAR. These include the following: matter type, staff, source or origin, contacts (firms, individuals, registered representatives, entities), securities products, markets, comments, correspondence (including relevant dates), high level allegations, rule violations, milestone or matter dates, dispositions or resolutions, billable entities, disciplinary actions (appeals, decisions, sanctions, fines, undertakings, restitution), information requests to firms as well as responses, time and activities. Those with access to the system are able to track down related documentation by contacting the person or office that input the relevant information.

jurisdiction, they likely would not have attempted to retrieve the anonymous letter. According to email records, no one in the Dallas office saw the letter until May 2009, when it was mentioned in newspaper articles regarding Stanford. At that time, Dallas staff searched various FINRA databases and uncovered a copy of the letter.[13]

4. Basagoitia Arbitration and Notice of SEC Investigation

In December 2004, the Associate Director of the Dallas office received an email from a FINRA enforcement attorney. The email referenced an arbitration between the Stanford firm and Leyla Basagoitia, a former Stanford financial adviser based in Texas. The Stanford firm had terminated Basagoitia and brought the arbitration to recover a balance on an employment promissory note issued to her. Basagoitia countered by alleging that she was improperly terminated. The email also indicated that the FINRA enforcement official had received a call from an SEC attorney from Fort Worth regarding the matter. The email further indicates that the SEC attorney

> is involved in the investigation of the claimant firm (Stanford Group Company) involving, among other things, the firm's coercion of representatives to sell Antigua CD's—Respondent's claim is that she was fired because she refused to sell the CD's without documentation and due diligence. [The SEC attorney] wanted to let [FINRA] know that [the SEC Attorney—*sic*, likely Basagoitia] has provided much assistance to the SEC in their investigation and that they believe there is a problem with selling the CD's—that the instruments are and were securities, etc.

The Associate Director forwarded the FINRA enforcement attorney's email to the Dallas Director and to four exam managers in the Dallas office, stating that he "was not aware of the SEC investigation re: Sale of Antigua CDs," and that he would call the SEC unless the Dallas Director or the managers already knew something about the investigation. When interviewed,

[13] The system described in footnote 12 does not give staff direct, electronic access to all regulatory information related to a member firm.

however, the Associate Director had no recollection of the above email and did not recall calling the SEC about the matter.[14]

A March 2005 email from an attorney in the SEC's Fort Worth office indicates that the Associate Director of FINRA's Dallas office was communicating with SEC staff regarding the Stanford firm. In the email, the SEC attorney wrote: "If you have any thoughts about the suitability issue I raised in connection with Stanford, or ideas about the firm generally, I would love to hear from you." The Associate Director has no recollection of this email or the referenced communication with the SEC attorney.

5. 2005 Cycle Examination

FINRA performed its next cycle exam of the Stanford firm in 2005. The exam team consisted of a lead examiner and three junior examiners. The lead examiner had been with FINRA's Dallas office since 2000. Each of the junior examiners had less than a year of experience with FINRA.

For approximately a year leading up to the 2005 cycle exam, the lead examiner had been assigned as the Stanford firm's core examiner. At the time, a core examiner was responsible for reviewing a firm's FOCUS[15] reports and its annual audited financial statements. The core examiner was also FINRA's primary contact with the member firm.

When interviewed, the lead examiner noted that he had developed numerous concerns about the Stanford firm in his capacity as its core examiner. In particular, he noted that most of the firm's revenues were derived from the sale of CDs issued by the Stanford bank. He also indicated being troubled by the size of the commissions paid by the bank to the firm for CD

[14] Other than an occasional email reference and one reference in an internal memorandum, based on interviews and records provided, the Dallas office did not memorialize its communications with the SEC about the Stanford matter.

[15] The Financial and Operational Combined Uniform Single ("FOCUS") report is a basic financial and operational report required of broker-dealers subject to minimum net capital requirements set forth in SEC Rule 15c3-1. The report contains figures on capital, earnings, and other financial details.

referrals. In his experience, commissions typically were not paid for CD referrals, and if a commission was paid, it was generally no more than $50 per referral. By contrast, the Stanford bank paid the Stanford firm an *annual* fee equal to *three percent of the deposit sum* for every CD account referred by the firm.

The lead examiner also reported having had concerns about the Stanford firm's net capital position, and he noted that the firm had received periodic capital contributions from Stanford. He also indicated that, about every two to three months, the firm's FOCUS report generated an "exception"—an event caused by data the FOCUS system deems irregular—associated with these capital infusions. The lead examiner further expressed the opinion that the firm was "hemorrhaging" money and was being kept afloat with capital contributions. He stated that he periodically questioned the firm's Chief Financial Officer about these capital infusions. The Chief Financial Officer tried to reassure him by noting that Stanford was a prominent and wealthy individual, as evidenced by his inclusion in the Forbes 400. The lead examiner never asked the Stanford firm to provide a personal financial statement from Stanford.[16]

Finally, when reviewing FINRA's files prior to the 2005 exam, the lead examiner came across a memorandum from the Texas State Securities Board and a *Wall Street Journal* article. The Texas State Securities Board memorandum was written in the mid-1990s and expressed concern that the high return rates and commissions for CDs made it difficult for the Stanford bank to make a legitimate profit on the CDs. The *Wall Street Journal* article reported that

[16] Based on representations in the Stanford firm's filings with FINRA, R. Allen Stanford was identified to the staff as the firm's sole director. In particular, in connection with the capital contributions made to the firm by Stanford, the firm submitted to FINRA corporate resolutions approving the contributions. These resolutions were executed by Stanford and identify Stanford as the sole director of the firm, as well as the sole shareholder of a holding company that owned 100 percent of the Stanford firm. As a director of the firm, Stanford would be deemed to be an "associated person," and FINRA accordingly had jurisdiction over Stanford individually. Thus, the staff could have questioned Stanford personally about the CD program, including the composition of the bank's portfolio and the accuracy of the marketing materials distributed by the Stanford firm.

Stanford possessed immense influence in Antigua. The lead examiner indicated that the Securities Board memorandum and the *Wall Street Journal* article were not the kinds of items typically found in a FINRA case file.

The lead examiner represented that he decided to inspect virtually every area of the Stanford firm's business in the 2005 cycle exam, but to give special attention to the CD issue. He believed that prior examiners had not paid sufficient attention to the CD program. His supervisor—an exam manager in the Dallas office—agreed with this approach. According to the manager, there were substantial concerns in the Dallas office regarding the Stanford firm and the CD program in particular. According to the lead examiner, he and his manager decided that it made sense to take a broad look and "see what we reel in."[17]

While the exam team was preparing for the 2005 cycle exam, an enforcement attorney in the Dallas office joined the discussion on the CD issue. The enforcement attorney had worked for the SEC prior to joining FINRA. When interviewed, she indicated that, during her time with the SEC, she had worked on a matter involving Stanford's CD program. She also reported working on cases involving brokered CDs, which had tested the bounds of the SEC's (and FINRA's) jurisdiction under the federal securities laws. From the moment she became involved in discussions regarding the CD aspect of the 2005 Stanford cycle exam, the enforcement attorney reportedly expressed the view that the Stanford CDs were *not* "securities" regulated under the federal securities laws, and were therefore outside of FINRA's jurisdiction.

As part of the pre-exam process for the 2005 cycle exam, the lead examiner sent the Stanford firm a questionnaire. In response to a question about underwriting, the firm indicated that it was offering the CDs under the SEC's Regulation D ("Reg. D"), which exempts securities

[17] The manager was one of the individuals who, in late 2004, had received a copy of the email discussing the Basagoitia arbitration and the SEC's investigation of the Stanford firm. Prior to the 2005 cycle exam, the manager informed the lead examiner for the 2005 cycle exam that the SEC was looking into the CD program.

offered in private placements to specified investors from the registration requirements of the Securities Act of 1933. The examiner noted that he decided to further investigate the Reg. D claim during the onsite portion of the exam.

The onsite portion of the cycle exam took place in late April and early May 2005. The lead examiner focused his time on the CD program, and delegated other portions of the exam to the junior examiners on the team. He asked the Stanford firm to provide due diligence materials on the Stanford bank and the CDs. In response, the firm supplied only the bank's annual report. The examiner noted that he was surprised to learn that, according to the annual report, commercial loans constituted less than five percent of the bank's assets. He asked the Stanford firm about this fact and was told that the bank's profits came from trading operations and investments. Given the advertised rates of return on the CDs, he stated that he found this hard to believe. Although it might have been possible to make high returns on investments in developing markets, according to the annual report, the Stanford bank mostly invested in developed markets. In his interview, the examiner expressed the opinion that, if the Stanford firm was really making the high return rates on the CDs through investments in developed markets, then they were "smarter than Goldman Sachs."

Junior members of the exam team reviewed certain Stanford customer accounts, but did not come across any evidence of funds going directly from a customer account at the broker-dealer to a CD purchase.[18] The exam team did not, however, look for evidence that customers of the Stanford firm were liquidating securities to buy into the CD program; for instance, they did

[18] FINRA's 2001 cycle exam report on the Stanford firm indicates that, "For existing broker dealer clients, funds are wired by Bear Stearns from the client's brokerage account to [the Stanford bank]." While this is not direct evidence that customers of the firm were liquidating securities to purchase CDs, it is an issue that should have been investigated. It is unclear whether any of the examiners for the 2005 cycle exam ever reviewed the 2001 exam file. For a description of how the SEC ultimately asserted jurisdiction over the Stanford CDs based, in part, on the argument that Stanford firm customers sold securities in connection with the purchase of CDs, see footnotes 20 and 52.

not cross-check CD purchases with sales of securities by the same customers. Such checks would have identified customers who sold securities and bought CDs through an intermediary step such as depositing the proceeds of securities sales in a bank. A showing that the firm's customers were liquidating securities in order to buy into the CD program would have provided FINRA's staff with jurisdiction[19] to proceed against the firm under the antifraud provisions of the federal securities laws, regardless of whether the CDs themselves constituted "securities."[20]

The lead examiner also looked into the firm's claim that the CDs were a Reg. D private offering. As a general matter, SEC rules prohibit companies from engaging in a general solicitation for Reg. D offerings. However, the examiner noted that the website of the Stanford bank contained a significant amount of information about the CDs, including interest rates. He asked the Stanford firm about this and was told that the firm had no control over the content on the bank's website. The examiner did not believe that the firm's lack of control over the bank excused the apparent violation of the Reg. D restrictions, and requested that the firm provide a written statement explaining why the bank's website was not a general solicitation.[21]

On June 9, 2005, the Stanford firm responded to the lead examiner's concerns, asserting that "[w]e believe that the descriptions of CD Products on the website of Stanford International

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[19] See footnote 52 below.

[20] In late 2008, FINRA's Boca Raton office obtained records during their exam of the Stanford firm's Miami office that indicated that a number of Stanford firm customers sold securities and simultaneously purchased CDs. Similarly, the SEC's motion in support of a temporary restraining order against Stanford indicates that "From August 2008 through December 2008 alone, approximately 50 [Stanford firm] clients liquidated approximately $10.7 million in stocks, bonds, and other similar securities and invested that money in [the Stanford bank's] CDs." Memorandum In Support of Motion for TRO, Prelim. Injunction and Other Emergency Relief, *SEC v. Stanford International Bank, Ltd. et al.*, N.D. Tex. 3:09-cv-0298-N.

[21] As referenced in the Stanford firm's audited financial statements dating back to at least fiscal year 2003, the firm had entered into a joint marketing arrangement with the Stanford bank. Specifically, the firm's annual audited financial statements indicate that "Pursuant to joint marketing agreements, the Company and an affiliated foreign financial institution agreed to jointly market and offer fixed income and trust products to their respective customers. In connection therewith, the Company is entitled to referral fees based upon percentages of the referred portfolio as defined in the respective agreements." It does not appear that FINRA staff confronted the Stanford firm with the existence of this joint marketing agreement.

Bank do not constitute a form of general solicitation. This is only general information on the Bank and its products and no current interest rates are posted on this site. An investor cannot purchase any CD product via the website." The letter also indicated that the firm did not believe the CDs to be securities subject to U.S. federal or state laws, and that the firm elected to treat the CDs as a Reg. D offering "because of the possibility that the CD deposits or CD certificates could be deemed to be 'securities' by US regulatory or judicial authority." The examiner was not persuaded by the firm's assertion that the CDs were not securities; however, he was uncertain as to whether FINRA could show that they were securities. This issue was not pursued further in the 2005 cycle exam.[22]

6. Meeting with SEC and the SEC Referral Letter

Shortly after the onsite portion of the 2005 cycle exam, on June 21, 2005, the Dallas Director and Associate Director attended a general meeting at the SEC's Fort Worth office. At that meeting, the SEC Assistant District Administrator informed the Dallas Director that the SEC was concerned about Stanford but was having difficulty pursuing the matter. The Assistant District Administrator then told the Dallas Director that the SEC would send FINRA a letter to see if it could help with the investigation.

When interviewed, the Dallas Director indicated that she was shocked that the SEC would refer the Stanford case to FINRA. If the SEC, with its subpoena power, was having problems bringing the case, she said she failed to understand how FINRA—which does not have

[22] There is no indication that the Dallas staff made any formal requests to identify the assets comprising the investment portfolio that allegedly supported the performance of the CDs or to interview Stanford firm employees regarding their knowledge of the CDs or the investment portfolio.

subpoena power—could be more successful. She did not, however, inform the SEC of these concerns at the time of the meeting.[23]

According to email records, in the days after the June meeting, Fort Worth SEC staff and the Dallas Director and Associate Director participated in at least one, and possibly several, telephone calls regarding the Stanford CD program. The Dallas Director could not recall whether she personally participated in the call(s), and noted that it was not unusual for the SEC to contact her staff directly. The Associate Director had no recollection of the substance of the call(s).[24]

On July 21, 2005, an attorney in the SEC's Fort Worth office sent a five-page letter to the Associate Director of FINRA's Dallas office. The letter began by referencing "our phone conversation," and provided "further information from [the SEC's] October 2004 examination of Stanford Group Company." The SEC letter also noted that, in the latter part of 2004, approximately 63 percent of the Stanford firm's revenues were derived from the sale of the CDs, and that the firm's customers held approximately $1.5 billion of the CDs as of October 2004. The SEC letter also indicated that, despite the dependence of its business on the CD sales, the Stanford firm "claims that it keeps no records regarding the portfolios into which [the Stanford bank] places investor funds and that it can not get this information from [the bank]. . . . [The Stanford firm's] admitted inability to get information from [the bank] about the investments underlying the CDs suggests that [the firm] may be violating NASD Rule 2310 (Suitability)."

The letter went on to indicate that, while the firm and the bank claimed that the investments offered were CDs, "[i]n reality, the offerings are either an investment contract or

[23] As discussed further at pages 36 and 65 of this report, FINRA Rule 2010 provides authority for FINRA to sanction member firms and registered representatives for conduct that fails to meet "just and equitable principles of trade," which can involve conduct that does not involve securities.

[24] No record of the substance of these calls was maintained by the Dallas office.

interests in an unregulated investment company." In a footnote, the letter set forth the SEC's legal argument as to why the CDs are securities subject to the federal securities laws:

> Neither [the bank] nor [the firm] are entitled to rely upon certain United States case law that holds that a certificate of deposit is not a security. First, [the bank], which is located in Antigua, does not meet the definition of a bank under Section 3 of the Securities Act of 1933 ("Securities Act"). Certainly [the bank] is not subject to regulatory oversight in the U.S. Although there are cases that have held that CDs issued by foreign banks may not be securities, (*Wolfe* [*sic*] *v. Banco Nacional de Mexico*, 739 F.2d 1458 (1984)) *these cases turn on the degree of protection offered by the bank regulatory system of the country of the issuing bank. . . . It is unlikely that Antigua's bank regulatory structure offers depositors a degree of protection from loss that corresponds to that which exists in the United States*. In contrast to bank CDs offered by banks in the United States, it appears that funds invested in [the bank's] CDs bear a significant risk of loss. Indeed, one document in [the bank's] marketing materials (as discussed below) notes that the investor's entire investment is at risk and that [the bank's] ability to continue to pay back principal and interest is dependent on [the bank] "continuing to make consistently profitable investment decisions."

(Emphasis added.)

Another section of the letter, under the heading "Possible Fraudulent Scheme," indicated that "[t]he CDs being offered appear too good to be true." The section also chronicled a variety of concerns associated with the CD program, including the highly unusual three percent annual concession paid for each CD referral, and the consistently high reported performance of the Stanford bank's investments during periods when most of the markets in which the bank claimed to invest were down substantially. The section also indicated that the Stanford firm engaged in sales practices commonly associated with fraudulent schemes, including "push[ing] its [registered representatives] to sell the CDs by engaging in aggressive sales contests," and possibly terminating representatives for refusing to sell the CDs.

In the final section of the letter, under the heading "Possible Misrepresentations/Omissions," the SEC indicated that it had requested, but was never provided with, specific information regarding how the Stanford bank's funds are invested. The SEC letter

also noted that the Stanford firm provides U.S. investors with only a limited—and potentially misleading—disclosure statement regarding the bank's investment portfolio and associated risks, while foreign investors receive even less information on the risks associated with their investments.

When interviewed, every member of the Dallas office who was asked about the SEC letter agreed that it was unlike any letter they had received in the past. Ordinary SEC referrals bear a referral number, contain little factual information, and begin with the phrase "we are referring the following matter." Despite the absence of this boilerplate language, the Dallas office staff understood the SEC letter to be a referral.

The leadership of the Dallas office decided to open a cause exam to investigate the allegations in the SEC referral letter. On August 5, 2005, the Dallas Director wrote to the SEC's Forth Worth office, acknowledging receipt of the SEC's letter, and indicating that FINRA had opened an examination to look into the matter. The August 5, 2005 letter also indicated that FINRA would notify the SEC's Fort Worth office of the outcome of its investigation.

On September 12, 2005, the SEC's Fort Worth office sent a request letter to the President of the Stanford firm. The letter indicated that the SEC staff believed the "CDs sold by the firm to be securities," and outlined a number of areas related to the CD program that required corrective action by the firm.[25] The letter also demanded that the firm halt and correct these violations, and report in writing how this was to be achieved. The letter expressly instructed that

[25] These included misrepresentations and omissions in statements to investors (in violation of SEC Rule 10b-5), excessive commissions (in violation of NASD Rules 2440, 2810, and 2830), failure to establish, maintain, and enforce written supervisory procedures (NASD Rule 3010(b)(1)), failure to conduct periodic reviews of customer account activity (NASD Rule 3010(c)), failure to develop and implement an adequate anti-money-laundering program (NASD Rule 3011), failure to file Treasury form 90-22.1 (Bank Secrecy Act), and failure to meet continuing education requirements (NASD Conduct Rule 1120).

the firm's response be sent not only to the SEC's Forth Worth office, but also to FINRA's Dallas Director.

7. Conclusion of the 2005 Cycle Examination

The lead examiner for the 2005 cycle exam was not assigned to the cause exam triggered by the SEC referral letter. His manager provided him with a copy of the referral letter, but did not inform him about the conversations with the SEC that took place at the June meeting or in any subsequent phone calls. The lead examiner stated that he reviewed the letter quickly in 2005 and believed it to be an "exam report." He thought the letter signaled that the SEC had taken over the CD case, and that it had referred only an advertising case to FINRA. As a result, he stopped focusing on the CD issues he had identified. He did not discuss his interpretation of the SEC letter, or his decision to curtail the cycle exam's inquiry into the CD program, with his superiors.

In an interview, the lead examiner was shown a copy of the SEC referral letter. He indicated that this document was what he had referred to as the SEC's "exam report." He stated that his characterization of the SEC letter as an exam report was clearly inaccurate, and agreed that the letter was a straight SEC referral on the CD issue. He also indicated that he had seen the September 12, 2005, letter from the SEC to the Stanford firm, and that this letter may have contributed to forming his opinion that the SEC was pursuing the CD case. He expressed regret that he had misinterpreted the SEC referral letter to FINRA, and indicated that, in light of his misinterpretation, he did not do all he could have done on the CD issue.

In January 2006, because of the lead examiner's case overload, his exam manager reassigned responsibility for completing the 2005 cycle exam to another examiner. The lead examiner transferred his files to the new examiner, after which his involvement in the exam

ended. The lead examiner never discussed his concerns about the CDs described herein with the examiner in charge of the 2005 cause exam. The 2005 cycle exam was completed in 2007. The exam resulted in a fine to the Stanford firm,[26] but did not result in any action related to the CD program.

8. 2005 Cause Examination

The Dallas office initiated a cause exam of the Stanford firm to address the CD issue in the summer of 2005. The same manager who had supervised the 2005 cycle exam, and had expressed concerns regarding the CDs, supervised the cause exam. The Dallas Director and Associate Director received periodic briefings on the progress of the exam. The cause exam was assigned to a senior examiner in the Dallas office who specialized in cause exams.

The same Dallas office enforcement attorney who had told the lead examiner for the 2005 cycle exam that the Stanford CDs were not securities was involved in the 2005 cause exam from its early stages. She was shown the SEC referral letter, likely just after the cause exam was initiated. After learning of the referral, she told the cause examiner and other FINRA staff that the SEC and other federal agencies, including the Postal Service and the FBI, had been looking at Stanford's CD program for some time. The enforcement attorney also told the cause examiner that none of these agencies were able to develop and initiate an enforcement proceeding against the Stanford firm. As chronicled below, during the cause exam, the enforcement attorney repeatedly expressed the view that the CDs were *not* securities, and that FINRA therefore lacked jurisdiction to pursue a suitability case related to the CD program.

Shortly after the Dallas office opened the 2005 cause exam, the cause examiner went to the SEC's Fort Worth office to inspect their case files on Stanford. Among those files, she found

[26] As a result of the 2005 cycle exam, the Stanford firm was fined $20,000 for improper check holding, including checks related to CD purchases.

a note, apparently from Leyla Basagoitia to an SEC attorney, chronicling a lack of transparency and due diligence within the Stanford firm regarding the CD program. The note also explained that the offshore CDs were "being primarily sold to unsophisticated investors in Latin America who have been led to believe that these investments are of a safe nature because they are being offered by a subsidiary of a regulated U.S. Corporation." The note surmises that, despite the extremely high advertised CD rates, "the value of the bank's assets are well below the value of its obligations to its clients. If this assumption proves to be true, Stanford has engaged in a very large Ponzi scheme." The cause examiner incorporated this letter into the exam file, but no further action appears to have been taken to determine what Basagoitia knew about the CD program.[27]

In October 2005, counsel for the Stanford firm sent FINRA's Dallas office a copy of a letter, which had also been sent to the SEC's Fort Worth office, disputing the SEC's assertion that the offshore CDs were securities. The letter cited case law from the Supreme Court indicating that CDs issued by banks in the United States and insured by the Federal Deposit Insurance Corporation were not "securities" for purposes of the federal securities laws.[28] The letter also emphasized two cases from the Ninth Circuit (including *Wolf v. Banco Nacional De*

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[27] In August 2005, the NYSE received a letter from Maria Perdomo of Venezuela regarding Stanford's CD program. The Perdomo letter indicates that Stanford had been "operating in Venezuela for several years without proper supervision and with sales people that are neither registered in the U.S. nor in Venezuela." The letter also indicates that these representatives

> offer an offshore product to clients that they are told the product is a Certificate of Deposit of a bank, when in reality the product is simply a "hedge fund." The public does not know in reality what they are investing in, thus are being deceived. This product, I believe if sold in the U.S. must have "prospectus", explaining all the risks involved and thoroughly explaining the product itself. . . . This bank, obviously doesn't lend money, it just takes money in so they can invest it in many things (bonds, commodities, margin purchases of stocks, etc, etc) all this happening without the client knowing the scope of their supposed "certificate of deposit."

NYSE forwarded the letter to FINRA. Ultimately, the Perdomo letter was incorporated into the 2005 cause exam. It does not appear that anyone associated with the exam followed up on the allegations raised in the letter.

[28] *Marine Bank v. Weaver*, 455 U.S. 551 (1982).

Mexico,[29] which were discussed in the SEC referral letter). These cases held that certain CDs issued in Mexico were not securities, despite the fact that the Mexican government only provided deposit holders with priority claim status—and not actual insurance—if the issuing bank became insolvent. The Ninth Circuit cases concluded that, despite this limitation, the availability of bank regulation in Mexico and that nation's history of successful banks rendered the CD investments virtually guaranteed. The Ninth Circuit also declined to address a claim that Mexican authorities were not enforcing Mexican bank regulations, citing the traditional respect paid to foreign governments by U.S. courts.

In the letter, Stanford's counsel argued that Antigua, like Mexico, provided CD holders with priority claim status. Stanford's counsel also argued that the Stanford bank was subject to comprehensive regulation in Antigua, and that U.S. courts were bound to show respect to this regulatory system.[30]

Although the examiner assigned to the 2005 cause exam was not an attorney, she assumed responsibility at the district level to assess the strength of the SEC's claim that the CDs were securities and the Stanford firm's response to the contrary. She was assisted in this task by a paralegal. It does not appear that the cause examiner or the paralegal consulted any case law concerning offshore CDs other than the cases referenced in the SEC referral letter and the Stanford firm's response.[31] Although the question whether the CDs were "securities" was

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[29] 739 F.2d 1458 (9th Cir. 1984). The other Ninth Circuit case cited by the Stanford firm's counsel is *West v. Multibanco Comerex, S.A.*, 807 F.2d 820 (9th Cir. 1987).

[30] The Stanford bank's CD program differed in several respects from CDs issued by federally regulated banks in the United States. First, in contrast to the insurance provided in the United States by the Federal Deposit Insurance Corporation, the Antiguan government does not guarantee any portion of the CD deposits or interest. Second, in contrast to most U.S. banks, the Stanford bank did not engage in much commercial lending, which might have brought an increased measure of stability to the CD program.

[31] The only other case consulted by the cause examiner—*Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith*, 756 F.2d 230 (2d Cir. 1985)—involved brokered CDs issued in the United States. This case does not appear to have any bearing on the question of whether offshore CDs issued by a bank in Antigua are securities, but the cause examiner found it to be significant. In general, a brokered CD refers to the practice of a broker

ultimately referred to Sales Practice Policy and the Office of General Counsel, no comprehensive legal analysis of the issue was ever conducted.[32]

The cause examiner stated that, based on her review of these materials, she was unable to conclude that the Stanford bank CDs were securities under the federal securities laws. The Dallas enforcement attorney involved in the 2005 cause exam agreed with this assessment. In her interview, the enforcement attorney explained that, earlier in her career, she had come across the "securities" issue in the context of brokered CDs. She recalled that the SEC and FINRA had only prevailed on the "securities" element in cases where brokered CDs were sold to the public through fractional interests. The CDs marketed by the Stanford firm were not fractionalized.

When interviewed, neither the enforcement attorney nor other staff involved in the 2005 cause exam could explain why the brokered CD analysis was determinative of the question whether the offshore Stanford CDs were securities. According to the enforcement attorney, the brokered CD cases showed that regulatory agencies did not always prevail in arguing that CDs were securities. The enforcement attorney explained that her job was to serve as a "gatekeeper" to prevent cases from moving forward to the enforcement stage unless they truly warranted formal action. She also indicated that, in her experience, Ponzi schemes do not last as long as ten years, and that the fact that the Stanford bank had been selling the CDs for such a long period of time gave the CD program some measure of credibility.[33]

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purchasing CDs from banks and reselling them to the public. The SEC and FINRA were concerned with the practice because investors did not necessarily purchase the CD itself, and often bought a fractional interest in the package of CDs held by the broker.

[32] See below at pages 33-35.

[33] In her interview, the enforcement attorney claimed that she considered the offshore element as part of her analysis of the issue, and that she bore suspicions regarding the regulatory regimes in certain Caribbean nations. However, there is no indication that she ever discussed these concerns with anyone involved in the 2005 cause exam; rather, all participants in the staff discussion regarding the cause exam recall that their analysis relied on the brokered CD case law. The enforcement attorney also does not appear to have created any documentation regarding her legal analysis of the CD issue in connection with the 2005 cycle or the 2005 cause exam.

In January 2006, the cause examiner referred a portion of the exam to FINRA's advertising regulation staff. The advertising regulation staff found a number of deficiencies with the Stanford firm's sales brochures, including insufficient warnings about the principal risks to U.S. investors and the absence of FDIC insurance for the CD program.

According to email records, the cause examiner also conferred with the lead examiner on the 2005 cycle exam regarding the CDs. Specifically, in February 2006, she emailed him to ask whether he had "any information about what customers were liquidating to purchase Stanford CD's from your routine exam?" The lead cycle examiner responded that he "recall[ed] that most of the trades that we looked at involved new clients who bought the CDs using cash, and they did not cash out other products or securities positions." When interviewed, the lead cycle examiner acknowledged that his response was not entirely accurate, as he failed to note that the 2005 cycle exam team did not check to see if CD purchases were being indirectly funded with proceeds from liquidated securities.

The cause examiner and the enforcement attorney discussed the "securities" issue at several meetings with other staff in the Dallas office, including with the Dallas Director and Associate Director. The Dallas Director recalls that the discussions focused on the brokered CD analysis. The discussions culminated in the preparation of an investigative conference report on the 2005 cause exam in April 2006.[34] The cause examiner drafted the report, but failed to include the fact that, according to the SEC's July 2005 referral letter, $1.5 billion in investor funds were potentially at risk. The report's jurisdiction analysis simply excerpted portions of the SEC referral letter and the Stanford firm's response to the SEC. The conference report's

[34] The investigative conference is a required element of every potential formal disciplinary matter. According to FINRA's Member Regulation Handbook, "the primary goal of the conference is to enable Enforcement and Member Regulation to reach consensus on the key aspects of an investigation, including issues, appropriate scope, and required evidence about the appropriate treatment of each matter."

discussion of the state of banking regulation in Antigua quotes from, and is based in significant part on, the representations of Stanford's counsel. The report concluded that, "Based on past cases and the documented protections that are offered by Antigua, the staff does not believe [FINRA] can adequately prove that the CD's are securities." This conclusion is debatable. As described below at footnote 52, the SEC in its case against Stanford reiterated its argument that the Stanford CDs are "securities."

The conference report also described the advertising portion of the cause exam, noting that Antiguan law does not in fact provide true priority claim status for CD holders, and described the protections offered by Antiguan law as "limited." Specifically, the advertising section indicates that Antiguan corporate law gives the payment of wind-up costs, the payment of officers and employees for up to three months prior to the seizure of the bank; all taxes due; and the "fees and assessments owing to the appropriate officer" priority over any portion of time deposit funds. In addition, the advertising section indicates that time deposit holders are only given preference over other creditors for up to $20,000 in deposit funds.[35]

In May 2006, the Dallas Associate Director forwarded the conference report to an attorney in FINRA's Sales Practice Policy group of the Member Regulation department in Washington, DC.[36] The Sales Practice Policy attorney had only been in that position since January 2006. When interviewed, she indicated that her job was to field legal questions from district offices, but that this role overlapped with the function of FINRA's Office of General Counsel, and that only the Office of General Counsel was authorized to develop the

[35] The conference report ultimately identified three potential violations of FINRA's advertising rules: (1) the brochures failed to contain the name of the Stanford firm and failed to make clear the firm's relationship with the bank; (2) the brochures failed to present a fair and balanced treatment of the risks and potential benefits of the CD program; and (3) the brochures claimed, inconsistent with the assertions made by the firm to FINRA, that the bank was not subject to the reporting requirements of any jurisdiction and that CD holders were not entitled to depositor protection.

[36] At the time, the group was known as "Regulation Policy."

organization's position on legal issues. Sales Practice Policy did not then and does not now have an internal handbook to guide its staff in fielding inquiries from district offices.

The Sales Practice Policy attorney was asked to review the conference report's conclusion that the "staff does not believe [FINRA] can adequately prove that the CD's are securities." She called an attorney in the Office of General Counsel to discuss the issue. During this call, which reportedly lasted about five minutes, the Office of General Counsel attorney indicated that CDs are typically not considered securities. The Sales Practice Policy attorney did not provide a copy of the conference report or inform the Office of General Counsel attorney that the CDs in question were issued by an offshore bank. Because the conference report did not reference $1.5 billion in potentially at-risk investor funds, neither attorney was aware of the magnitude of the potential fraud. In an interview, the attorney from the Office of General Counsel stated that she found it hard to believe that neither the Dallas office nor Sales Practice Policy perceived the foreign element of the CDs as the key issue in determining whether the CDs were securities. When presented with the conference report and the SEC referral letter for the first time in her interview, the Office of General Counsel attorney indicated that, had she known the facts outlined therein, she would have focused the securities inquiry on the degree of protection offered by the Antiguan regulatory system, and that her conversation with the Sales Practice Policy attorney would surely have lasted more that five minutes.[37]

After the phone call described above, the Sales Practice Policy attorney recalls that she contacted the Dallas office and indicated that she and the Office of General Counsel attorney were unable to confirm that the Stanford bank CDs were securities. In June 2006, the Dallas Associate Director sent an email to the Dallas Director and other office staff indicating that Sales

[37] Neither attorney documented their communications with each other, nor did they create any written record memorializing what, if any, legal analysis they conducted.

Practice Policy and the Office of General Counsel agreed with the staff's assessment of the securities issue.

Meanwhile, in June 2006, Bernerd Young—the former head of FINRA's Dallas office who had left in 2003—joined the Stanford firm as Managing Director of Compliance. The Dallas staff did not consider Young's presence to have compromised the 2005 cause exam.

In 2006 and 2007, while the cause exam was still ongoing, the manager overseeing the exam attended several general meetings with the SEC's Fort Worth office.[38] At one of these meetings, he informed the SEC that FINRA's enforcement staff could not endorse the proposition that the CDs were securities. According to the manager, the SEC staff questioned whether FINRA could bring anything more than an advertising charge.[39]

During interviews, the Dallas staff were questioned repeatedly regarding the conclusion that the CDs were not securities. The Director, the Associate Director, and the manager who oversaw the cause exam expressed reliance on the opinion of the enforcement attorney, as well as the confirmation by Sales Practice Policy and the Office of General Counsel. The enforcement attorney expressed the view that, even in 2009, she is not sure that the Stanford bank's CDs are securities.

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[38] Minutes maintained by the SEC's Fort Worth office of a February 17, 2006 meeting attended by staff from the SEC, FINRA and the Texas State Securities Board note that, "[FINRA] is pursuing concerns regarding Stanford Group's advertising. The brochure used to sell its affiliates supposed CDs is unbalanced regarding the risks and benefits. Whether or not the CDs are securities is irrelevant in terms of the advertising rules because it covers all communications." This occurred approximately three months before the Dallas office contacted the Sales Practice Policy attorney to get input on the Dallas staff's assessment that they could not pursue a suitability case against the Stanford firm.

Minutes maintained by the SEC's Fort Worth office of a March 16, 2007 meeting attended by the SEC, FINRA and various state regulators notes in reference to FINRA and the Stanford firm that "This matter was referred by the SEC. The firm's sales materials were run through the [FINRA] advertising department and serious disclosure and advertising deficiencies were noted. [FINRA] expects that their case will be strictly a 2210 Communications with the Public case. The SEC is looking at the issues related to whether the firm's products, which are sold as CDs, are securities."

[39] The Stanford firm ultimately settled the advertising charge for $10,000.

Dallas staff were also asked whether they ever considered bringing an enforcement action under FINRA Rule 2010—formerly NASD Rule 2110—which allows the organization to enforce "just and equitable principles of trade" at member firms. This Rule is not limited to fraud in connection with the sale or purchase of securities, and has been used by FINRA in a series of cases involving a variety of fraudulent conduct at member firms not involving "securities." The cause exam manager recalled considering this rule at the start of the exam, and could not recall why it was not pursued. The Associate Director had no recollection of considering the Rule, and expressed doubt as to whether it could serve as the basis for an enforcement proceeding. The Dallas Director expressed the opinion that Rule 2010 was not a stand alone rule and that FINRA can only bring 2010 enforcement actions if the member firm has violated some other FINRA Rule. This interpretation of Rule 2010 is not substantiated by the text of the rule, or by FINRA practices in prior enforcement actions.[40]

Finally, the Dallas Director, the cause examiner, and the enforcement attorney all noted their views that, as of 2005 and 2006, they did not have sufficient indication that the Stanford CDs were a fraudulent scheme to justify taking further action at that time. The SEC referral letter, however, contains numerous indications of fraud in connection with the CD program which were not investigated by the Dallas office.[41] The Dallas Director did not share the SEC

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[40] Other FINRA employees also differed in their understanding of Rule 2010. The Regional Chief Counsel of FINRA's New Orleans office—who serves as the enforcement attorney's supervisor—indicated that FINRA takes a conservative approach to using the rule in enforcement matters. By contrast, the attorney from the Office of General Counsel indicated that Rule 2010 can be used expansively. The Office of General Counsel attorney also indicated that, when she had been employed at the SEC, SEC attorneys noted that the SEC did not have a provision like FINRA Rule 2010. For a general discussion of Rule 2010, see page 65 of this report.

[41] In particular, the letter indicates the following:

> SIB [the Stanford bank] claims it is investing in "foreign and U.S. investment grade bonds and securities, and Eurodollar and foreign currency deposits" and "securities from established, quality companies and governmental agencies from around the world." Yet, SIB's high interest rates are inconsistent with its claimed portfolio. Minimum guaranteed interest rates since 2000 have ranged from approximately 3.5% to over 6% for short-term investments. For the Index-Linked CD tied to the S&P 500, the minimum guarantee has been approximately 3.5% or a percentage of the return

referral letter or her office's decision not to investigate the CDs with senior FINRA management until December 2008.

The Dallas staff would have faced substantial hurdles in obtaining information from a non-member offshore entity such as the Stanford bank. While the Special Committee understands that the issue of whether the CDs were in fact "securities," as defined under the Exchange Act, is debatable, there were sources of information regarding the potential fraudulent scheme available from the Stanford firm—the U.S. broker-dealer—that the Dallas staff did not investigate in 2005 and 2006. In addition, the Dallas staff could have sought expert analysis of the advertised CD rates (coupled with the annual three percent concession and overhead costs) and their consistency with the claimed portfolio, as well as the claim of consistent profitability over the prior ten years.

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of the S&P 500, whichever is higher. The brochures given to investors indicate that that percentage of participation may vary at SIB's direction, but suggest a participation rate of *125%* of the S&P 500. We are unaware of any legitimate short-term investment that not only guarantees a return significantly higher than a CD, but allows you to participate in up to 125% of equity market returns. Moreover, SIB pays an *annual* 3% trailer, which is troubling, as it adds significant, on-going costs which SIB must meet before it can generate a profit. We are unaware of any legitimate, short-term, low or no-risk investments that will pay a 3% concession every year an investor keeps his funds invested in any product.

Further, SIB's annual audit casts doubt upon its claims of consistent profitability over the last 10 years. For example, from 2000 through 2002, SIB reported earnings on investments of between 12.4% and 13.3%. This return seems remarkable when you consider that during this same time frame SIB supposedly invested at least 40% of its customer's assets into the global equity market. Ten of 12 global equity market indices were *down substantially* during the same time frame. The indices we reviewed were down by an average of 11.05% in 2000, 15.25% in 2001 and 25.87% in 2002. It is equally unlikely that the portion of the portfolio invested into debt instruments (approximately 60%) could make up the expected losses in the equity portion of the portfolio. For example, in 2002, when the global indices were down 25%, the debt portion of the portfolio would have to generate an approximately 40% return for SIB to generate the 12.4% overall return it claimed in 2002.

Finally, the Staff learned from persons formerly associated with SGC [the Stanford firm] that it also appears to be engaged in sales practices that are commonly associated with fraudulent activities. The firm pushes its RRs to sell the CDs by engaging in aggressive sales contests. Prizes offered include trips to Antigua and automobiles. One RR has stated that she was fired for her refusal to sell SIB CDs. Moreover, the SGC has refused to provide to the selling RRs any further disclosure other than the minimal information it provides to potential investors regarding the specifics of SIB's investment portfolio.

It is impossible to say whether, if the staff had taken these steps, they would have developed evidence sufficient to bring a fraud case against the Stanford firm. However, the Dallas staff may well have learned that employees of the Stanford firm were not adequately informed about the investments underlying the CD program, that material representations made in the marketing materials for the CDs were, in fact, false, and that Stanford firm customers were liquidating securities to purchase CDs based on those false representations. This information would have been relevant in building a case against the Stanford firm and its registered and associated persons, including Stanford himself, for violations of the anti-fraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5.

9. 2007 Cycle Examination

The next cycle exam of the Stanford firm occurred in 2007, at which time approximately 43 percent of the total revenues of the firm were attributable to the CD program. Although the lead examiner assigned had worked as an examiner since 2004 and had been in the Dallas office since 2006, she had no prior experience with the Stanford firm.[42] Other staff on the cycle exam included one other relatively senior examiner and two examiner trainees.[43]

In preparing for the 2007 exam, the exam team decided not to investigate the CDs. When asked to explain this decision, the lead examiner indicated that she did not see the utility of repeating the work that was done during the 2005 cause exam. She also indicated that the exam manager who had overseen the 2007 cycle exam made the decision not to look at the CDs.

[42] Similarly, the manager who supervised the 2007 cycle exam had little prior experience with the Stanford firm, though he was aware of the 2005 cause exam because the exam had been discussed at certain management meetings of the Dallas office.

[43] No member of the 2007 cycle exam team had been with the Dallas office while Bernerd Young was in charge.

When interviewed, the manager did not recall making this decision, but agreed that a decision to exclude the CDs from the exam could not have been made without his input.[44]

When interviewed, the 2007 cycle examiner indicated that her manager had called the SEC prior to the 2007 exam and inquired about the status of the SEC's investigation. The examiner recalled that the SEC told the manager that it was currently awaiting information from the Stanford firm, and that there were no particular steps that they wanted FINRA to take regarding the CDs. The manager had no recollection of the call, and the call is not documented in the exam file. The manager indicated that the decision to exclude the CD program from the 2007 cycle exam was driven by the results of the 2005 cause exam, and not by any deference to the SEC's parallel investigation.[45] The 2007 cycle exam report contains no documentation of the decision to exclude the CD program from the exam.

10. 2007 Miami Branch Examination and 2009 Unannounced Branch Examinations

In late 2007, a new Associate Director and the manager responsible for the 2007 cycle exam in Dallas decided to refer an examination of the Stanford firm's Miami office to FINRA's office in Boca Raton, Florida. When interviewed, they indicated that the branch exam was necessary to follow up on certain deficiencies in the firm's research reports that had been uncovered during the 2007 cycle exam. In their view, the Boca office was best positioned to conduct the exam because the office was closer to Miami, and the referral would spare Dallas staff from an extended examination outside of their home district.

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[44] It does not appear that the focus of the 2007 exam was approved by anyone above the exam manager. At the time the exam was focused, the Associate Director had left the Dallas office, and his replacement had not yet arrived. In addition, during this period, the Dallas Director began splitting her time between managing the office and her new responsibilities as Regional Director.

[45] Numerous FINRA staff noted the organization's longstanding practice of not deferring action on issues regarding a member firm unless specifically requested by the SEC.

The Dallas office did not transmit any of the information regarding the CDs—such as the SEC referral letter—to the Boca office. In an email to the Boca office, the manager responsible for the Dallas 2007 cycle exam indicated that the firm's Miami office "was selected for two reasons: (1) large # of reps working in the branch office (I think it's over a 100) and (2) they perform market making activities in the branch. In our quest to conduct more branch exams, we decided to pick a branch of this firm during the main office field work. Other than that, *there are no red flags* or specific people to focus on during the branch." (Emphasis added.)

Although the branch exam referral from Dallas did not mention the CDs, the Director of FINRA's Boca Raton office told his exam team to look into the CD program. He had observed a number of advertisements in the Miami area press touting the financial success of the Stanford firm, and also was familiar with Young and another individual in Stanford's compliance department, which led him to conclude that the firm warranted further attention. In contrast to the approach employed by the Dallas office, the Boca office decided to focus their exam on the CDs regardless of whether they ultimately turned out to be securities.

The Boca exam team consisted of an exam manager, an examiner with two years of experience, and an examiner who had just been elevated from trainee status. The most junior examiner had participated as a trainee in the 2007 cycle exam of the Stanford firm conducted by the Dallas office and knew generally that the SEC had looked into the CD program. However, neither he, nor any member of the Boca exam team, was aware at any point during the branch exam of the existence of the SEC referral letter or of any of the key details regarding the CD program that were then known by the Dallas office. Thus, the Boca exam team was required to assemble the examination of the CD program from scratch.

In December 2007, the Boca exam team went to the Stanford firm's Miami branch office. The exam team was precluded by the firm from speaking with its employees unless a member of the firm's compliance staff was present in person or via telephone. During the exam, the team inspected documentation related to the CDs, including logs of customer files that had been "pouched" from the firm to the Stanford bank. The team also discovered that representatives of the Stanford firm were engaged in sales contests involving the CDs. Finally, the team discovered that, at the time, roughly 90 percent of the revenues of the Stanford firm's Miami office were derived from the sale of the CDs.

On January 3, 2008, the Boca exam team sent a document request under FINRA Rule 8210 to the Stanford firm.[46] The request sought information about the Stanford bank's investment portfolio. In response, the firm provided some materials regarding the CDs, but did not provide any substantive information about the investment portfolio.[47]

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[46] Rule 8210 allows FINRA to inspect the books and records of the member firm, as well as certain owners of the member firm. The rule is a critical tool in FINRA's investigative arsenal. Because FINRA lacks subpoena power, Rule 8210 has been characterized as "one of the staff's primary tools for carrying out its regulatory responsibilities." (NASD Notice to Members 99-45 (November 1999)).

The rule itself states:

> For the purpose of an investigation, complaint, examination, or proceeding authorized by the FINRA By-Laws or rules, an Adjudicator or FINRA staff shall have the right to: (1) require a member, person associated with a member, or person subject to FINRA's jurisdiction to provide information orally, in writing, or electronically (if the requested information is, or is required to be, maintained in electronic form) and to testify at a location specified by FINRA staff, under oath or affirmation administered by a court reporter or a notary public if requested, with respect to any matter involved in the investigation, complaint, examination, or proceeding; and (2) inspect and copy the books, records, and accounts of such member or person with respect to any matter involved in the investigation, complaint, examination, or proceeding.

FINRA's By-Laws define the phrase "person associated with a member" to include "(1) a natural person who is registered or has applied for registration under the Rules of the Corporation; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the Corporation under these By-Laws or the Rules of the Corporation; and (3) for purposes of Rule 8210, any other person listed in Schedule A of Form BD of a member." In general, Schedule A of Form BD requires disclosure of the direct owners and executive officers of the broker-dealer.

[47] The exam team viewed the portfolio information as being critical, but did not consult with resident enforcement attorneys regarding the Stanford firm's failure to produce it.

In the summer of 2008, the Boca Director came across news stories indicating that the SEC had issued subpoenas to former Stanford firm employees Charles Rawl and D. Mark Tidwell.[48] The Boca Director immediately asked the branch exam team for an update on the status of the exam. The team informed him that the Stanford firm was resisting document requests related to the Stanford bank on the grounds that the firm and the bank were separate legal entities. The Boca Director instructed the team to send another Rule 8210 request to the firm, again asking for information regarding the bank's investment portfolio. The team sent the second 8210 request on August 27, 2008.

In December 2008, news of the Madoff investment scheme broke. Prompted in part by this news, the Boca Director again asked the exam team for a progress update. The team showed him the response to the August 27, 2008 document request. This response consisted of advertising materials for the CDs, but did not include any information concerning the Stanford bank's portfolio. The exam team indicated that Young did not appear to know what was in the bank's portfolio, even though he claimed to have done personal due diligence on the bank. In his interview, the Boca Director described Stanford's response material as mere "propaganda."

The refusal of the Stanford firm to provide information on the bank's investment portfolio prompted the Boca Director to research the firm's website. He found nothing of substance other than a report on the Stanford firm's charitable activities. He also inspected the bank's annual report and found it devoid of any substantive information regarding the bank's assets. In addition, the Boca Director inspected the Stanford firm's recent financial statements and was surprised to find that the firm claimed to be thriving at a time when the economy was in recession and peer firms were struggling. The Boca Director contacted a senior colleague at

[48] Rawl and Tidwell had been terminated by the Stanford firm, and, according to an exam team member, both had negative sales figures with respect to the CDs at the time of their termination.

FINRA's national office who had substantial experience in fraud cases, who agreed that the information regarding the Stanford firm was troubling.

The Boca Director then contacted the Dallas Director and Associate Director to relay his concerns about the Stanford firm. According to the Boca Director, the Dallas Director informed him that her office had already looked into the CDs and had determined that there was nothing for FINRA to pursue. The Boca Director then contacted the SEC's Miami office. The SEC's Miami office, in turn, put him in contact with the SEC's Fort Worth office. In mid to late December, the Boca Director spoke to the Regional Director of the SEC's Fort Worth office and was told that the SEC was looking into the Stanford firm.

At this point, the Boca Director decided that significant action was necessary. He conferred with the Dallas Director about the possibility of conducting unannounced onsite exams of various branch offices of the Stanford firm, and obtained permission to devote additional resources to the branch exam, including a forensic computer consultant. The Boca office also began interviewing former employees of the Stanford firm, including those who had been subpoenaed by the SEC.

Concurrently, the Boca exam team was furthering their inquiry into the CD program. As part of this effort, the exam team searched the SEC's EDGAR database for companies in which the Stanford bank might have invested. They uncovered only 13 such companies, which suggested to the team that the bank was not investing primarily in stocks, but rather in illiquid assets. The Boca examiners also reviewed FINRA's Central Registration Depository ("CRD")[49] to determine if any registered representatives were employed at the Stanford firm in addition to the Stanford bank or other Stanford companies. The examiners noted that a search for dually

[49] CRD is an electronic database that functions as the central licensing and registration system for the U.S. securities industry and its regulators. It contains the registration records of more than 4,800 registered broker-dealers and the qualification, employment, and disclosure histories of more than 660,000 active registered individuals.

employed representatives was a way of trying to get around the firm's claims that it had no access to information regarding the bank's portfolio.[50]

On December 30, 2008, the Boca examiners, together with two employees from the Dallas office, interviewed Rawl and Tidwell (the former Stanford firm employees who were the subject of SEC subpoenas). Rawl and Tidwell addressed the CD program, and indicated their belief that the Stanford bank was merely a dumping ground for Allen Stanford's failed investments. They also noted that the bank's portfolio was managed by an individual based in the Stanford firm's office in Tupelo, Mississippi. This information provided the exam team with another possible avenue for seeking information about the portfolio.

On January 9, 2009, the Boca office spearheaded six simultaneous, unannounced exams of Stanford firm branch offices.[51] Staff from the Dallas office assisted in some of these exams. Interviews conducted during these exams disclosed that the investment portfolio underlying the CDs was comprised of three tranches. Tier 1, which totaled approximately $200 million, were cash equivalent assets; Tier 2, which totaled approximately $300 million, were monitored by Stanford Financial Group analysts. No one but Stanford and one colleague had information about Tier 3 investments, which represented the vast bulk of the bank's $7.2 billion of claimed assets. After the unannounced exams, FINRA turned over the materials it had uncovered in the branch offices to the SEC. On February 16, 2009, the SEC filed a civil complaint alleging securities fraud against Stanford and his associates. The complaint named the Stanford firm and

[50] Certain marketing materials obtained by the Boca examiners from the Stanford firm's Miami office indicated that Stanford Financial Group ("SFG") provided management services in connection with the investment portfolio for the CDs. The examiners identified a number of U.S. based employees that were Stanford firm employees with series 7 registrations and that were also employed as analysts for SFG. As registered employees of the Stanford firm, FINRA had authority to question such employees about their outside business activities, even if such activities were not "securities" related. This investigative step was not taken during the prior Stanford exams.

[51] The Boca Director intended to conduct an examination of the Stanford firm's main office in Houston as well, but the Director of SEC's Forth Worth requested that FINRA refrain from doing so because the SEC wished to enter that office.

the Stanford bank as defendants. On the same day, the SEC obtained a temporary restraining order freezing Stanford's assets.[52]

In an interview, the Dallas Director was asked what had changed by 2009 to warrant FINRA's shift in attitude toward the Stanford firm. She indicated that she realized since 2005 that there was something wrong with the Stanford firm and that it was not the "cleanest" firm. She maintained, however, that FINRA did not have enough evidence of fraud in 2005. She acknowledged that the Stanford bank's claimed rates of return were a "red flag," but questioned how FINRA could have proven the fraud without access to the bank's records. She could not explain why the Boca office was able to pursue the investigation of the CDs in 2008 in ways that the Dallas office had not in 2005 and 2006.

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[52] In the civil case against Stanford and his associates, the SEC has set forth detailed argument as to the manner in which the Stanford CD program implicates the anti-fraud provisions of the Securities Exchange Act of 1934. First, the SEC alleges that customers of the Stanford firm sold millions of dollars of stocks and bonds in order to invest in the CDs. Based on this allegation, the SEC argues that the Stanford case involves fraud in connection with the sale of securities. See *SEC v. Zandford*, 535 U.S. 813, 825 (2002) (holding that the "in connection with" element of section 10(b) of the Securities Exchange Act of 1934 is satisfied by "a fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide.").

In the alternative, the SEC maintains that the Stanford bank CDs themselves constitute "securities" subject to the anti-fraud rules of the 1934 Act. The SEC's argument is based principally on *Reves v. Ernst & Young*, 494 U.S. 56 (1990). Although *Reves* did not involve CDs or foreign-based instruments, the case sets forth the analysis as to whether instruments denominated as "notes" are "securities." As in prior "securities" cases, the *Reves* opinion emphasized the need to "examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." *Id.* at 67. The *Reves* opinion, however, focuses specifically on availability of federal regulation. *Id.* at 69 (observing that "the notes here would escape federal regulation entirely if the Acts were held not to apply."). According to the SEC, CDs issued by foreign banks necessarily fail to meet this element. The SEC acknowledges in a footnote that pre-*Reves* lower court cases—including the pair of Ninth Circuit cases discussed above at pages 25 and 29-30—had excluded certain foreign CDs from the securities laws, but argues that those cases are inconsistent with *Reves*. See Memorandum In Support of Motion for TRO, Prelim. Injunction and Other Emergency Relief, *SEC v. Stanford International Bank, Ltd. et al.*, N.D. Tex. 3:09-cv-0298-N.

It also should be noted that, although the Stanford bank was nominally subject to regulation and inspection by the Financial Services Regulatory Commission of Antigua, according to the indictment in one of the pending criminal cases, Stanford bribed the Commission's Chief Executive Officer not to audit the bank. In addition, Stanford and the Commission's Chief Executive Officer allegedly conspired to thwart inquiries by U.S. enforcement authorities into the bank's portfolio and operations.

B. The Madoff Case

1. Background

In 1960, Bernard L. Madoff ("Madoff") founded Bernard L. Madoff Investment Securities, LLC ("the Madoff firm") and registered it with the SEC as a broker-dealer. Madoff was at all times the chairman and sole owner of the Madoff firm. The firm was a pioneer in the electronic trading of equities and was one of the first firms to join the NASDAQ. The firm became a prominent and well-respected market maker—a firm that facilitates trading in a particular security by simultaneously offering both to buy and sell the security from other broker-dealers, with the goal of making a profit from the spread between its purchases and sales. Indeed, the firm, which was never a member of the NYSE, is often credited with helping to invent the "third market"—*i.e.*, the trading of NYSE-listed stocks over-the-counter rather exclusively than on the NYSE. The firm also engaged in substantial proprietary trading for its own account. The firm's market making and proprietary trading operations constituted a successful broker-dealer business for many years. According to the firm's broker-dealer filings, neither the market making nor proprietary trading activities involved the maintenance of customer accounts.[53]

In addition to his broker-dealer businesses, Madoff also operated an investment advisory business through the same firm. The investment advisory business was, in actuality, a gigantic Ponzi scheme. According to his March 2009 plea allocution in federal court, Madoff solicited money from investors, representing to most of them that the money would be invested in stocks

[53] Madoff and some members of his family became well-known members of the financial community. Madoff served as Chairman of NASDAQ in the early 1990s. His brother, Peter Madoff, served on the NASD Board, including as Vice Chair, as well as various committees. Madoff's son, Mark Madoff, served on the NASD's National Adjudicatory Council. In 2008, his niece, Shana Madoff, served on FINRA's Compliance Advisory Committee. Interviews of FINRA staff and review of exam files identified no information to suggest that the Madoff firm received preferential or lenient treatment because of Madoff's prominence or his family's history of service to NASD and FINRA.

and options using a "split strike conversion strategy" which, he promised, would yield consistent, above-market rates of return.[54] Instead, Madoff deposited the money into bank accounts and used the principal contributed by later investors to pay returns to earlier investors. According to the SEC, the Madoff firm never executed a single securities trade in the course of the investment advisory business, nor did it engage other brokers to execute such trades. The client account statements, order tickets, trade confirmations, and other documentation relating to the investment advisory business were wholly fabricated and completely fictitious.

Madoff went to considerable lengths to conceal his investment advisory scheme and keep it separate from the broker-dealer business of the firm. For example, the market making and proprietary trading side of the Madoff firm used bank accounts held at the Bank of New York. These accounts were reflected in the firm's books and records, the FOCUS reports that it filed with FINRA, and the audited financial statements that it filed with both FINRA and the SEC.[55] The investment advisory business, on the other hand, used accounts at JP Morgan Chase, which were not reflected in regulatory filings made by the Madoff firm in connection with its broker-dealer operations. Similarly, the fictitious trading activity and securities positions that Madoff reported to his investment advisory clients did not appear in the records of the firm's broker-dealer business.

Although FINRA's New York-based staff examined the Madoff firm on a regular basis, FINRA did not learn of the Ponzi scheme—or see the firm's records of its purported investment activities—until after Madoff confessed to his sons and was arrested by the FBI on December 11,

[54] As explained by Madoff to his investment advisory clients, the "split strike conversion strategy" consisted of buying a subset ("basket") of common stocks in the Standard & Poor's 100 Index ("S&P 100") before an expected run-up in the S&P 100 and selling the basket after the index had risen. The downside risks of this effort to time the market were purportedly hedged—and the consistent returns achieved—by purchasing put options on the S&P 100 funded by sales of call options on that index.

[55] According to filings in a recent action by the SEC, the auditor of the Madoff firm produced and signed these audit reports, but did not actually perform any audits of the Madoff firm.

2008. The next day, a team of FINRA examiners joined staff from the SEC and FBI at the Madoff firm offices where, for the first time, they reviewed records related to the Ponzi scheme, much of it gathered from Madoff's personal desk and the firm's secret office space on the 17th floor of the Lipstick Building in New York.

In the 1980's, Madoff established a United Kingdom corporation, Madoff Securities International Ltd. ("MSI"), that operated as an affiliate of the Madoff firm. MSI was registered with the U.K. Financial Services Authority and engaged principally in proprietary trading. Bernard Madoff owned 30 percent of MSI, served as Chairman of its Board of Directors, and, according to public reports, exercised control over its operations. MSI was identified as an affiliate in the Madoff firm's Form BD.[56]

A third broker-dealer—Cohmad Securities Corporation ("Cohmad")—is also relevant to FINRA's oversight of Madoff. Cohmad was founded in 1985 by Madoff and Maurice Cohn. Madoff and his brother, Peter, together owned 24 percent of the firm.[57] Cohmad operated out of the 18th floor of the Madoff firm's offices, reportedly renting both space and equipment from the Madoff firm. It did not have a separate reception desk or signs; a visitor to the Madoff firm would have been unaware that Cohmad was there.

During the period relevant to this report, Cohmad was registered as a broker-dealer and reported having approximately 750 to 850 customer accounts, which were held by and cleared through Bear Stearns Securities Corporation. These accounts usually generated roughly 300 transactions per month, mostly in equities and, to a lesser extent, municipal bonds.

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[56] Form BD is the Uniform Application for Broker-Dealer Registration. Broker-dealers use Form BD to register with the SEC, FINRA, and other self-regulatory organizations through the CRD system. A broker-dealer is required to update its Form BD by submitting amendments whenever the information on file becomes inaccurate or incomplete for any reason.

[57] The Madoff ownership interests were disclosed in Cohmad's Form BD.

Cohmad derived the vast majority of its revenues from the Madoff firm. For example, its audited financial statements for the year ended June 30, 2005, showed that more than 90 percent of its revenue ($7.1 million out of $7.8 million) was derived from the Madoff firm. By the end of 2005, its revenue from the Madoff firm had grown to 95 percent of its total revenues. Cohmad characterized these revenues as "fees for account supervision" in its internal accounting records and as "brokerage service fees" in its audited financial statements.[58] According to FINRA's 2004 examination report, Cohmad represented to FINRA that

> [A]pproximately 85 percent of the firm's revenue is generated from the execution services it provides to Bernard Madoff, a non-affiliated broker dealer. . . . Cohmad through its clearing firm, has access to the DOT [Designated Order Turnaround] system whereby it can route its listed securities for execution to the floor of the New York Stock Exchange ("NYSE"). Madoff utilizes this service through Cohmad because it is not a member of the NYSE. Cohmad earns fees from Madoff for this service, however, there are no written contracts between Madoff and Cohmad.

The Madoff firm apparently paid these fees by writing a single check each month for a specific amount, calculated down to the penny. These "brokerage service fees" —which would have been expected to vary depending on the volume of the trades routed to the NYSE—were frequently the same from month to month. For example, these payments, as reflected in Cohmad's internal financial records, were as follows during 2005:

Jan.	$548,092.82	May	$581,150.17	Sept.	$581,150.17
Feb.	$548,092.82	June	$581,150.17	Oct.	$581,150.17
Mar.	$889,676.83	July	$604,914.24	Nov.	$581,150.17
April	$581,150.17	Aug.	$581,150.17	Dec.	$581,150.17

After the Madoff scandal broke in December 2008, Cohmad admitted to FINRA staff that these fees were, in fact, compensation for bringing clients into Madoff's investment advisory business. The Cohmad representatives stated that this compensation was originally tied to NYSE

[58] In its FOCUS filings, Cohmad recorded these revenues on the line identified as "Fees for account supervision, investment advisory and administrative services."

trades that the Madoff firm routed though Cohmad, but eventually just became a "number" selected by Madoff based on the number of clients referred and the amount of new funds invested.[59] Cohmad further stated that this change from one type of compensation to another had come about due to the decimalization of trading on the NYSE. Between 2000 and 2008, these payments totaled over $67 million.

2. Registration of the Madoff Firm as an Investment Adviser

According to public reports, from 2003 to 2005, SEC staff examined the Madoff firm in response to complaints that the firm was running an unregistered, multi-billion dollar investment advisory business that operated as a Ponzi scheme.[60] In January 2006, the SEC's Enforcement Division opened an investigation of the matter. The investigation was closed without formal action after the Madoff firm agreed to register as an investment adviser. FINRA was never informed of the complaints, the SEC's investigation, or its resolution.[61]

In September 2006, the Madoff firm registered with the SEC under the Investment Advisers Act by filing Form ADV through IARD, an electronic database system which FINRA has contractually agreed to operate and maintain on behalf of the SEC. The Madoff firm's Form ADV represented, among other things, that it had approximately $17 billion under management for 23 clients, and was compensated through commissions. The Madoff firm also

[59] According to lawsuits filed by the SEC and the Massachusetts Securities Division, these fees were calculated as a percentage of the total cumulative amount of principal that Cohmad had brought into Madoff's Ponzi scheme, less any amounts withdrawn by clients.

[60] Based on a review of the available evidence, it appears that FINRA never received any similar complaints about the Madoff firm.

[61] In May 2006, SEC staff contacted FINRA to request data on over-the-counter options positions held by the Madoff firm and also spoke to the Vice President and Deputy Director of the FINRA Amex Regulation Division to gather background information on various options trading strategies. The SEC staff informed the Vice President that they were preparing for a deposition of Madoff (implying that an investigation was under way), but did not disclose what they were investigating or why.

represented that it (rather than a related person or third party) had custody of its advisory clients' funds and securities.

The Madoff firm did not update its registration as a broker-dealer to reflect this investment advisory business. Its Form BD, maintained in FINRA's CRD database, continued to disclose its types of business *only* as "Broker or dealer making inter-dealer markets in corporation securities over-the-counter" and "Trading securities for own account." In fact, even though it had registered as an investment adviser, the Madoff firm never disclosed to FINRA that it was engaged in any business other than market making and proprietary trading.[62]

3. 2007 Cycle Examination

As a registered broker-dealer and FINRA member, the Madoff firm was subject to periodic cycle exams by FINRA's Member Regulation department. As discussed above, the frequency of cycle examinations is generally based on an assessment of the risk of violations posed by a particular firm. At all times relevant to this report, the Madoff firm held itself out to FINRA as a market-making and proprietary trading firm that did not have any customers or maintain any customer accounts. Over the years, examinations of the firm had found only a few, relatively minor, regulatory violations even though the firm usually processed more than two million transactions per month. As one FINRA staff member explained, the Madoff firm was viewed as a "clean" firm with an excellent examination history. In light of this, the firm was designated as Category 2 and was examined every other year. The most recent—and most relevant, in light of the investment adviser registration and certain financial information in its broker-dealer records—examination is discussed in detail below.

[62] The Madoff firm filed its form ADV with the IARD system. Although FINRA operates both the CRD system (as a self-regulatory organization) and the IARD system (as a vendor), the systems are separate and data in the two systems are not reconciled. There are, for example, no automated checks to ensure that information in a firm's Form BD is consistent with its Form ADV.

FINRA conducted its most recent cycle examination of the Madoff firm in January and February 2007. The examination was performed by a single examiner from FINRA's New York district office. The examiner had several years of experience and was considered by his superiors to be highly-skilled and thorough.

In accordance with FINRA's normal practices, the 2007 cycle examination began with a standard pre-examination phase in which the examiner gathered information about the firm from FINRA's internal sources. This phase included reviews of the prior (2005) cycle examination report, the firm's FOCUS filings and audited financial statements, its examination history as reflected in the STAR system, and records of its corporate bond trading as reflected in the TRACE system.[63]

As part of the normal pre-examination process, the examiner accessed FINRA's CRD system and printed out a paper version of the Madoff firm's Form BD. Because the Madoff firm had not updated this form to reflect its investment advisory business, the printout contained no indication that the firm had registered as an investment adviser. The only hint that the examiner might have seen in FINRA's internal records that the firm was an investment adviser would have been a link, "View IA Record," that would have been displayed in some, but not all, of the screens in the CRD system. This link appeared only on CRD screens for firms that had a record in the IARD database. The 2007 cycle examiner (like the vast majority of FINRA examiners) did not have direct access to the IARD system and, accordingly, could not have viewed the firm's record in IARD even if he had clicked the link. The examiner did not notice the link and,

[63] According to the cycle examiner and other personnel from the New York district office, as of 2007, except for confirming the internet address of a firm's website, FINRA did not routinely run internet searches prior to conducting a examination. The cycle examiner ran a Google search prior to the exam to find out more about Madoff, whom he understood to be an innovator in electronic trading and a prominent member of the financial community. His Google search did not reveal that Madoff was managing money or acting as an investment adviser. The use of pre-examination internet searches has increased since the Madoff scandal broke, but FINRA has not issued any guidelines on how such searches should be conducted or the kinds of information they should target.

in any event, reviewing a firm's Form ADV was not required or even recommended under FINRA's pre-examination procedures at the time.[64]

In early January 2007, the examiner contacted the Madoff firm to inform it that FINRA would be conducting an onsite examination and sent an email to Shana Madoff, the firm's Compliance Counsel (and Madoff's niece) requesting that the firm provide information about the types of business in which it engaged by answering a web-based information request ("WebIR"). The firm completed the form the next day, indicating that it engaged only in market making (10 percent of revenues) and proprietary trading (90 percent of revenues). It did not check the box on the form for "Investment advisory services" or indicate that it had any revenues from any type of "retail" business—*i.e.*, from transactions with persons other than broker-dealers or institutional investors. In response to an email following-up on its WebIR response, the firm stated that its transactions were all "RVP/DVP [receive versus payment/deliver versus payment]," meaning it did not regularly hold customers' cash or securities as part of its trading activities.

FINRA's examination staff planned the 2007 cycle examination believing that the Madoff firm was, as it claimed, strictly a market maker and proprietary trader. Accordingly, the examination covered only the mandatory elements for such a firm—*e.g.*, verification of its net capital, review of its written procedures and supervisory controls, and examination of its trade reporting (corporate bonds were selected). The entire examination required 78.5 hours of work, the bulk of which was devoted to verifying the firm's net capital computation and reviewing its corporate bond trades.

[64] Although very few examiners had access to the IARD system, the public versions of the Forms ADV of registered investment advisers were available through the SEC's website.

The onsite portion of the 2007 cycle examination started on January 24, 2007 with a background interview of Bernard and Shana Madoff. During this interview, the FINRA examiner was (again) informed that the firm engaged only in market making and proprietary trading, did not receive customer funds, and did not receive customer securities. Although the firm disclosed its London affiliate, it did not mention Cohmad during this interview.

The Madoff firm also gave the examiner a tour of its offices on the 18th and 19th floors of the Lipstick Building, which were connected by an internal staircase and appeared to house the entirety of the firm's operations. The examiner was not shown the firm's offices on the 17th floor, on which its investment advisory business was located. Those offices were not connected to the internal staircase and—according to press reports—were not marked by a sign. The examiner never had any indication that the offices on the 17th floor existed.

The examiner spent an entire week at the Madoff firm performing the field work for the examination. He recalled that the firm promptly answered his questions, was responsive to his requests for documents, and gave him no reason to be suspicious. Madoff stopped by to speak to the examiner every day, but did not hover or attempt to steer the examiner toward or away from any areas of inquiry.

Throughout the examination, the Madoff firm provided the examiner with documents and records *only* from the market making and proprietary trading side of its business, not from its investment advisory operation. For example, in advance of his field work, the examiner had sent a written records request for "Bank Statements and Cancelled Checks" for the third quarter of 2006. The examiner was given statements only from the Bank of New York accounts (used by the broker-dealer business), not from JP Morgan Chase (used by the investment advisory business). The records request also asked for information about customers who had opened new

accounts since the last cycle examination (in 2005). The Madoff firm indicated that it had no customers and no customer accounts.[65] And, although the examiner reviewed the firm's trading records, those documents did not reflect the fictitious trades that Madoff represented to his advisory clients he had made on their behalf.

Audited annual financial statements prepared by the auditor of the Madoff firm—Friehling & Horowitz CPA'S P.C.—did not disclose the existence of any of the investment advisory accounts. In a pending case against Friehling & Horwitz, the SEC has alleged that the auditor was financially dependent on Madoff, that it knowingly or recklessly made false statements related to its audits of the firm, and that it failed to perform any meaningful evaluation of the firm's customer accounts and internal controls. FINRA's procedures for confirming auditor independence were limited to confirming that the auditing firm was licensed and was a different legal entity from the broker dealer being audited.

The records provided by the Madoff firm to the examiner during his field work contained no indication that the firm was engaged in an investment advisory business or had advisory clients. To the contrary, they were entirely consistent with the normal records of a broker-dealer engaged solely in market making and proprietary trading, as the firm claimed to be. Based on the firm's representations and the absence of evidence contradicting those representations, the examination report noted that many of the mandatory examination elements related to customer protection were simply inapplicable because "[t]he firm . . . does not have any customers."

The examiner completed his field work on February 1, 2007, and the examination report on February 8, 2007. The examination report found that two violations of applicable regulations had occurred. First, the Madoff firm had understated its net capital (of more than $543 million)

[65] The Madoff firm appears to have disclosed that it had accounts for seven of its employees, but that these accounts had been completely inactive during the examination period.

by $7,201.68 (a 0.001 percent error) because it had omitted dividends earned in September 2006 on a money market account held at another broker-dealer. (The firm's minimum required net capital was $1 million, so even with the error, its excess net capital was $542 million.) Second, the examination found certain delays and errors in the firm's reporting of corporate bond trades, which were a small part of its proprietary trading operations. The examiner communicated these findings to Madoff during an exit conference on February 8, 2007.

The examiner then submitted the examination report—which recommended that FINRA issue a letter of caution to the Madoff firm for the bond trading violations—to the exam manager. After requesting minor revisions, the manager approved the report and submitted it to the Associate Director, who approved it on May 9, 2007. The Associate Director signed the recommended letter of caution on May 15, 2007, ending the examination.

4. 2003 and 2005 Cycle Examinations

FINRA also conducted routine, cycle examinations of the Madoff firm in 2003 and 2005. These examinations—which took place before the firm had registered as an investment adviser—were very similar to the 2007 cycle examination: they were each conducted by a single examiner, covered only FINRA's mandatory examination elements, and found only minor regulatory violations (if any at all). During these examinations, the firm represented to FINRA examiners that it was engaged solely in market making and proprietary trading and, accordingly, did not have any customers or customer accounts, did not hold customer securities, and did not receive customer funds. The firm also concealed its investment advisory activities from the examiners by, for example, not providing them with bank account statements from JP Morgan Chase where the investment advisory funds were maintained.

5. Assessment of the Madoff Firm Examinations

The 2003, 2005, and 2007 cycle examinations of Madoff did not find any evidence that the firm was operating an investment advisory business, much less a Ponzi scheme. As noted above, the firm concealed its investment advisory operations from FINRA and took elaborate steps to keep that business separate from its broker-dealer business. Its investment advisory business consisted, at bottom, of a bank account and fictitious customer accounts that were not reflected on the broker-dealer's books. FINRA's examination program during the relevant period was not designed to detect the type of fraudulent activities in which the Madoff firm engaged.[66]

Nonetheless, FINRA's examinations of the Madoff firm—particularly the 2007 examination—presented several opportunities to have gathered more information about the firm's investment advisory business. During the 2007 cycle examination, FINRA staff did not obtain or review the Madoff firm's Form ADV.[67] When interviewed, FINRA staff involved in the Madoff firm examinations stated that they would have asked more questions if they had known the firm was an investment adviser. A comparison of the firm's Form ADV would have shown inconsistencies with the representations it made to FINRA. For example, the Form ADV stated that the firm had 23 customers (it actually had thousands more), even though it told FINRA it had none. The Form ADV stated that the firm (rather than a related person or third

[66] To take one example, FINRA's verification of a firm's net capital—a mandatory element of every cycle examination—is principally aimed at confirming the existence of the assets reflected on the firm's books, not at detecting undisclosed assets such as the accounts of the Madoff firm at JP Morgan Chase.

[67] Under existing law, FINRA does not have jurisdiction to regulate activities under the Investment Advisers Act. FINRA's examination program did not focus on identifying and reviewing the investment advisory activities of its members for possible violations of the Exchange Act and FINRA's own rules. Until recently, FINRA's pre-examination procedures did not require examiners to determine whether a firm was registered as an investment adviser, and its computer systems did not permit most examiners to access the IARD. Even where a broker-dealer disclosed that it was also an investment adviser, FINRA's examination program did not contain any specific guidance as to which elements should be added to an examination in that situation.

party) had custody of $17 billion of assets belonging to those customers, even though it represented to FINRA that it did not hold any customer assets. Finally, the Form ADV stated that the Madoff firm executed trades for its customers—trades that were not reflected in the firm's broker-dealer records because they had not, in fact, taken place. A careful review of the Form ADV would have led to questions about where advisory clients' assets were being kept and how transactions for those clients were being executed. Such questions would not necessarily have uncovered the fraud, but would have provided the 2007 examiner with highly relevant lines of inquiry.

FINRA's review of the financial records of the Madoff firm presented additional opportunities. An important part of FINRA's regulatory mission is ensuring that member firms have adequate capital and are not at risk of financial collapse. During each cycle examination, examiners devote a substantial amount of time to verifying a firm's net capital computations by, among other things, tracing all of the firm's assets to third-party documents such as bank statements and account records. As several FINRA staff members explained, because of the importance of the net capital requirement, cycle examinations tend to focus intensively on analyzing and testing a firm's balance sheet (its assets and liabilities), but devote little attention to the firm's income statement (its revenues and expenses). For Category 2 firms, at least, FINRA's examination program did not require that revenues or expenses—even very large ones—be specifically analyzed, much less traced to supporting documents. As one examiner explained, FINRA examiners are expected to ask questions if they notice unusual revenues or expenses, but such inquiries are incidental to the net capital review and need not be pursued beyond receiving facially reasonable answers. A more comprehensive approach to examining

revenues and expenses might have provided two opportunities to have uncovered information regarding the firm's undisclosed investment advisory business.

First, although it had never done so before, the Madoff firm began to report "commission" revenue in its monthly FOCUS reports starting in September 2006—the same month in which it filed a Form ADV stating that it was compensated for its investment advisory services through commissions.[68] As alleged in the various criminal cases arising from the Madoff scandal, these "commissions" were actually the result of round-trip transactions in which Madoff transferred money from one of the Madoff firm's off-the-books accounts at JP Morgan Chase to the London affiliate, and then transferred it to one of the Madoff firm's on-the-books accounts at Bank of New York. These "commissions" totaled approximately $8 million, $108 million, and $90 million in the years ended September 30, 2006, 2007, and 2008 respectively. During 2007, they constituted more than 60 percent of the Madoff firm's reported revenue.

Commissions are a somewhat unusual source of revenue for a firm engaged solely in market making and proprietary trading, which normally would generate revenues from buying and selling securities for its own account, not from charging commissions to execute trades. FINRA's computer systems screen firms' FOCUS filings using certain algorithms to identify unusual or potentially problematic activity and generate exception reports which are reviewed and investigated by FINRA staff. The Madoff firm's FOCUS filings underwent this screening, but the system did not flag these commission revenues as a potential problem. For example, the legacy NASD FOCUS system, whose algorithms had not been updated since the mid-1990's,

[68] The Madoff firm reported "commission" revenue of nearly $8 million (out of total revenues of more than $34 million) in its September 2006 FOCUS report.

screened for new (*i.e.*, previously unreported) types of revenue, but created an exception report only if the new revenue was greater than 25 percent of a firm's total revenue in the period.[69]

During the 2007 cycle examination, the examiner reviewed the Madoff firm's financial records and its consolidated FOCUS report for the period from July through September 2006. The examiner noticed the new "commission" revenue of approximately $8 million—amounting to 23 percent of the Madoff firm's total revenue during the period—and asked about it. When interviewed, he recalled that someone, probably Shana Madoff, explained that the commissions had been paid by the firm's London affiliate on trades that the firm had executed for it. Although this might have signaled a shift in the firm's business, the answer seemed reasonable to the examiner, did not relate to any of the examination elements he was performing, and did not raise any "red flags." The examiner did not further pursue the matter and did not, for example, request supporting documentation for the commissions or proof of the underlying trades.

Second, as part of the 2007 cycle examination, the examiner made a standard request for the Madoff firm's bank statements (along with copies of its cancelled checks) that were needed to verify the firm's net capital computations.[70] Most of the cancelled checks were unremarkable and were for only a few hundred or few thousand dollars. However, one of the cancelled checks, to "Cohmad Securities," was for a much larger amount, $524,611.03. The examiner had never heard of Cohmad, had not seen any indication that it was operating out of the same office space as the Madoff firm, and was unaware that Madoff was an owner of Cohmad.[71] He did not recall

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[69] FINRA is currently in the process of transitioning legacy-NASD firms from NASD's Centralized FOCUS ("cFOCUS") system to the NYSE's Electronic FOCUS ("eFOCUS") system, which includes more sophisticated screening algorithms.

[70] As noted above, the firm provided the requested information only for its accounts at Bank of New York and not for its accounts at JP Morgan Chase.

[71] In FINRA's New York district office, firms are assigned to groups of examiners (each headed by an examination manager) alphabetically. The Madoff firm was assigned to the group handling the "B's" while Cohmad was assigned to a different group handling the "C's."

noticing this check or asking about it, but also stated that he did not believe he would have thought that a check in this amount from one broker-dealer to another was significant or relevant to the examination he was performing. Although this was the single largest check provided to the examiner, FINRA's procedures—which did not emphasize review of a firm's expenditures—would not have required him to inquire about it or request backup documentation.

6. Examinations of Cohmad Securities

Cohmad was a small broker-dealer. For most of the period relevant to this report, it was designated as a Category 2 firm and examined by staff from FINRA's New York office every other year—*e.g.*, 2002, 2004, and 2006. These examinations found only relatively minor regulatory violations and either were closed with a letter of caution or simply filed without action. At some time after the 2006 cycle examination, Cohmad was moved to Category 3, whose firms are examined every fourth year. FINRA, accordingly, did not perform a cycle examination of Cohmad in 2008.[72]

FINRA's 2006 cycle examination of Cohmad took place during February through April 2006. It was performed by two relatively junior examiners, one of whom led the examination while the other focused principally on Cohmad's municipal securities business.

The 2006 Cohmad cycle examination began with a pre-examination phase in which the lead examiner gathered information about the firm. During this process, he reviewed Cohmad's FOCUS filings and its audited financial statements, which disclosed that Cohmad's principal source of revenue came from the Madoff firm. The notes to Cohmad's audited financial statements for the year ended June 30, 2005, discussed these revenues under the heading "related party transactions and revenues" and specifically disclosed that they had been earned by

[72] FINRA did conduct an Alternative Municipal Examination ("AME") of Cohmad's municipal securities business in 2008, as required by the Municipal Securities Rulemaking Board. The AME did not include any field work and focused solely on Cohmad's (then-inactive) municipal securities business.

"provid[ing] brokerage services to an entity owned by a minority shareholder of [Cohmad]." Cohmad's response to the WebIR indicated that 95 percent of its revenue came from "brokerage fees." The lead examiner recalled that, during the background interview at the start of the examination field work, Cohmad representatives explained these revenues by stating that they related to trades Cohmad performed on the NYSE for the Madoff firm.

The "brokerage services" rendered to the Madoff firm were the single most important part of Cohmad's business. As noted above, the payments for these services also followed an unusual pattern. The 2006 cycle examination's review of these "brokerage fees" was limited to asking about them during the background interview. The lead examiner recalled that his manager had instructed him not to review them because the Regulatory Coordinator for the section—who was responsible for reviewing Cohmad's FOCUS filings and audited financial statements—was already aware of them. The manager had little recollection of the 2006 examination and could neither confirm nor deny that such instructions had been given. It is possible that the manager based this decision on the results of prior examinations, including the 2004 cycle examination which had obtained the detailed explanation for these revenues (quoted above at page 49).

For whatever reason, the 2006 cycle examination did not review the "brokerage fees" paid from the Madoff firm to Cohmad by, for example, requesting documentation of how the fees had been calculated or of the underlying trades in NYSE-listed stocks. Although the examination did review Cohmad's trading records—a mandatory examination element—that review was limited to transactions in municipal securities, an area for which Cohmad had received letters of caution in the past. Cohmad's equities transactions were removed from the examination's focus and were not reviewed during the 2006 cycle examination, apparently

because prior examinations had not found problems in this area. This normally mandatory element was also omitted from the 2004 cycle examination.[73]

FINRA's review of the areas that were included in the examination plan appears to have been thorough and complete. The 2006 cycle examination found a variety of minor regulatory violations, mostly related to Cohmad's written supervisory procedures and its handling of municipal securities transactions. The examination was concluded with a letter of caution to the firm.

FINRA's failure to examine the "brokerage fees" paid to Cohmad by the Madoff firm was a missed opportunity. Unlike the Madoff firm examiners, the Cohmad examiners were aware that Cohmad and the Madoff firm were related parties. The pattern of payments between these parties—often for identical amounts each month—was facially inconsistent with their being based on actual equities transactions. Moreover, because of their size, for these revenues to have been actual "brokerage fees," Cohmad would had to have handled a very significant volume of transactions on behalf of the Madoff firm. A request for documentation underlying these purported "brokerage fees" might have uncovered the fact that the fees were for referring clients to Madoff's undisclosed investment advisory business. This discovery alone may not have uncovered the Ponzi scheme, but it would have undermined the Madoff firm's longstanding representations to FINRA that it did not maintain any customer accounts.

In conclusion, the examinations of both the Madoff and Cohmad firms provided FINRA examiners with opportunities which, in hindsight, might have led to the discovery of Madoff's

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[73] The report of the 2004 cycle examination explained:

> Staff reviewed the results of the firm's 2002 examination and noted no evidence or concerns regarding the firm's equity transactions. Considering that there has been no major changes to the firm's business and/or procedures, that there were no previous issues regarding the reporting of the firm's equity securities, and that all of the firm's equity transactions are reported by its clearing firm, Bear Stearns, no further review was warranted.

Ponzi scheme if they had been pursued. However, FINRA's examination program did not focus on the areas in which these opportunities arose. Because of its lack of jurisdiction over investment advisory activities, FINRA's examination program did not require its examiners to obtain or review the Madoff firm's Form ADV. Because of the program's focus on verifying net capital and completing specific exam elements, the examiners did not review significant revenues claimed by the Madoff and Cohmad firms beyond seeking oral explanations of what the revenues were. FINRA's procedures did not require the examiners to go further by, for example, requesting supporting documentation or testing the firms' representations against third-party information. Although FINRA's examinations did present the opportunities discussed above, its examination program did not exploit them because it was not designed to ferret out a sophisticated fraud, like Madoff's Ponzi scheme, that was kept almost entirely "off the books" of a member firm.

IV. OVERVIEW OF FINRA'S JURISDICTION

FINRA lacks jurisdiction to regulate a significant percentage of the financial institutions, products and transactions in our country. Of particular relevance for purposes of this review, FINRA lacks the authority to inspect for or enforce compliance with the Investment Advisers Act. In addition, FINRA lacks jurisdiction to directly obtain information from or regulate banks, insurance companies, savings and loan institutions, mutual funds or hedge funds.

FINRA's jurisdiction generally extends to any securities activity by a FINRA member firm or associated person that is governed by the Exchange Act or FINRA's rules.[74] This includes jurisdiction to enforce the anti-fraud provisions of the Exchange Act and SEC rules, such as Rule 10b-5.[75]

Under FINRA Rule 2010, FINRA has the authority to enforce "just and equitable principles of trade" with respect to member firms and associated persons. The SEC has held that this authority permits FINRA to sanction member firms and associated persons for a broad range of unlawful or unethical activities, including those that do not implicate "securities." For example, the SEC has approved FINRA disciplinary actions involving conduct related to insurance applications[76] and premiums,[77] tax shelters,[78] the general entrepreneurial activity of member firms,[79] and even to a member firm employee's improper use of a co-worker's credit card.[80]

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[74] See Exchange Act § 15A(b). FINRA also has jurisdiction to enforce compliance with the rules of the Municipal Securities Rulemaking Board.

[75] Rule 10b-5 is limited to implicating the sale or purchase of "securities" as defined by the Exchange Act.

[76] *In the Matter of Thomas E. Jackson*, 45 SEC 771 (June 16, 1975).

[77] *In the Matter of Ernest A. Cipriani, Jr.*, 51 SEC 1004 (February 24, 1994).

[78] *In the matter of Daniel C. Adams*, 47 SEC 919 (June 27, 1983).

[79] *In the matter of DWS Securities*, 51 SEC 814 (November 12, 1993).

[80] *In the matter of Daniel D. Manoff*, SEC Release No. 34-46708 (October 23, 2002).

FINRA's jurisdiction is limited to activities subject to the Exchange Act and FINRA rules occurring anywhere in the legal entity, regardless of whether the activity is carried out by the nominal broker-dealer unit or by some other unit within the member firm. For example, to enforce compliance with the Exchange Act or FINRA rules, FINRA has jurisdiction to obtain information about securities transactions executed as part of an investment advisory business that is conducted within the legal entity registered as the broker-dealer.[81] FINRA, however, has not utilized the full extent of its jurisdiction.

The Exchange Act and SEC rules require FINRA to regulate the conduct of certain persons associated with a member firm. Specifically, the Exchange Act and SEC rules require FINRA to regulate the conduct of "securities persons"—that is, partners, officers, or certain employees of the member firm. The Exchange Act and SEC rules also require FINRA to regulate the conduct of "control persons"—that is, those who have the power to direct or cause the direction of the management or policies of the member firm. These definitions can encompass legal as well as natural persons—*i.e.*, both companies and human beings—and are not limited to domestic entities or individuals.[82]

Certain of FINRA's own rules and bylaws, however, limit its jurisdiction—other than for purposes of inspections and review of books and records—to natural persons associated with the member firm.[83] By contrast, NYSE's old rules—which FINRA has only implemented for firms who are members of NYSE—assert broader jurisdiction over certain associated entities. In

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[81] See Exchange Act §§ 15A & 19(g); SEC Rule 19g2-1, and Adopting Release No. 34-12994 (November 18, 1976); see also FINRA Rule 2010, NASD Rule 2210, and FINRA Regulatory Notice 08-66 (October 2008) (stating that "[FINRA Rule 2010] applies to all of the business of a broker-dealer, not only to its securities and investment banking business," and that "[NASD] Rule 2210 is not limited to a broker-dealer's securities and investment banking business.").

[82] See Exchange Act § 19(g)(2); SEC Rule 19g2-1.

[83] See FINRA Rule 0140; FINRA's By-Laws at Article I(rr); see also FINRA Regulation, Inc.'s By-Laws at Article I(gg).

particular, NYSE Rule 304 asserts jurisdiction over any legal or natural person who either controls a member firm, or engages in a securities business and is controlled by or under common control with a member firm. The Exchange Act would not preclude FINRA from applying this type of authority to all FINRA member firms, and not just NYSE members.

FINRA is required to enforce compliance with the Exchange Act, Exchange Act rules and FINRA's own rules by each member, its "securities persons" (partners, officers, or certain employees of the member firm), and any person who controls the member. SEC rules relieve FINRA from the obligation to conduct examinations of control persons or other associated persons who are not "securities persons."[84] FINRA is, however, not relieved of the duty to enforce compliance by control persons. SEC rules do not prohibit FINRA from conducting examinations of a member firm's control persons and other associated persons if FINRA carefully considers the related burdens on its resources and on the examined entities.

To date, FINRA has not asserted broad authority to examine entities associated with a member firm. Rule 8210 only permits it to inspect the books and records of certain direct owners of a member firm. This review has not found any cases or SEC proceedings addressing this right to inspection, suggesting that FINRA has been reluctant to push the boundaries of Rule 8210. This review also has not found any reported case in which FINRA has attempted to assert inspection authority over indirect owners or affiliates of member firms.

FINRA has broad authority to adopt rules governing the natural persons who carry out member firms' broker-dealer business, imposing qualification standards on those individuals and regulating the substantive conduct of that business. FINRA's ability to regulate individuals' non-broker-dealer activities is more circumscribed. The SEC and the courts have upheld the

[84] See SEC Rule 19g2-1.

application of certain FINRA rules to the non-broker-dealer portions of firms' businesses. Examples include FINRA rules that (a) require individuals to provide their employer with advance notice of outside securities and non-securities activities;[85] (b) prohibit individuals from engaging in certain outside securities activities without their employer's approval;[86] and (c) require that certain outside securities activities be supervised and recorded on the employer's books and records as if the activity were being performed on behalf of the employer firm itself.[87]

[85] NASD Rules 3030 and 3040(b).

[86] NASD Rule 3040(c)(3).

[87] NASD Rule 3040(c)(2).

V. FINRA ACTIONS SINCE THE STANFORD AND MADOFF SCHEMES

The Special Committee has been informed by FINRA staff that, prior to the completion of this review and subsequent to the Madoff and Stanford schemes coming to light, FINRA has made changes to its regulatory programs to strengthen its efforts in a number of areas. These include the following: enhancing fraud training for examiners; developing more detailed procedures which will better support examiners' efforts to detect potential fraud during examinations; enhancing use of publicly available information during the pre-examination process; reviewing a sub-set of closed cases to evaluate whether they were the product of sound analysis and appropriately documented in the files; and expanding its review of arbitrations to include employer-employee disputes in the event of whistleblower allegations.

In addition, in March 2009, FINRA created the Office of the Whistleblower. The purpose of this initiative was to offer an improved way for those providing complaints or tips to reach senior staff who can quickly assess the level of risk involved and make sure each complaint or tip is properly evaluated. Those complaints warranting additional review and investigation are subject to an expedited regulatory response and are reviewed by experienced senior staff upon receipt. The Office of the Whistleblower can be reached through a toll-free number and through an internet address. This initiative has resulted in twelve referrals to the SEC, three referrals to other self-regulatory organizations and five referrals to other FINRA departments.

Finally, the staff has indicated its plan to develop a financial fraud unit. The purpose of this unit, which will combine the Office of the Whistleblower, Central Review Group, enforcement resources and industry experience, is to heighten FINRA's review of incoming allegations of serious frauds; provide a centralized point of contact internally and externally on

fraud issues; have a real-time platform for discussion of potential fraud within the organization; develop internal expertise in expedited fraud detection and investigation; and better consolidate regulatory information.

VI. RECOMMENDATIONS

The recommendations below are intended to enhance the effectiveness of FINRA's examination program by increasing its ability to detect fraud and improve its investor protection functions. In analyzing these recommendations for implementation, FINRA management should seek to achieve the following strategic objectives: (i) greater emphasis should be placed on the detection of fraud; (ii) potential fraud situations and other situations presenting serious potential risk to investors should be escalated promptly and properly; (iii) examination staff should be diligent in pursuing potentially serious issues, exercising an appropriate degree of skepticism; (iv) all FINRA operating units should closely coordinate and communicate in carrying out the examination program; and (v) FINRA should provide additional resources to strengthen its cause examination program.

While a number of these recommendations can be effected by FINRA alone, others will require the concurrence of the SEC and a critical recommendation as to the expansion of FINRA's jurisdiction will require Congressional action. Virtually all of these recommendations will require FINRA management and the Board to make decisions about resource allocation and adequacy. FINRA should continue to move quickly to implement those recommendations that it can undertake unilaterally.

1. Jurisdiction

A. Seek Jurisdiction to Regulate Activities Under the Investment Advisers Act. FINRA's examination program is fundamentally hampered by its lack of jurisdiction over investment advisory activities. A large number of firms and a significant percentage of registered persons are also registered under the Investment Advisers Act.[88] In providing these

[88] As of August 2009, there were 925 firms registered both as broker-dealers and investment advisers.

services and managing investors' assets, therefore, these firms and individuals are largely beyond the reach of FINRA and under a less robust regulatory scheme. FINRA should proactively seek jurisdiction to regulate activities under the Investment Advisers Act. This additional jurisdiction would enable FINRA to be more effective in detecting fraud in both broker-dealers and investment advisers. If FINRA had an investment adviser examination program, it might well have identified the Madoff fraud at the time of his registration as an investment adviser. If Congress grants FINRA the authority to implement an examination program under the Investment Advisers Act, it will be able to conduct a joint exam and analyze and compare data on both broker-dealer and investment adviser activities to confirm the accuracy of data and identify problematic patterns and potential frauds. This recommendation requires action by Congress.

B. Clarify FINRA's Current Jurisdiction; Expand Jurisdiction to Affiliates of Member Firms. FINRA should clarify the extent of its jurisdiction to examine member firms and bring actions to enforce the Exchange Act and FINRA rules and it should utilize that jurisdiction fully in appropriate circumstances. FINRA should determine those situations warranting the exercise of jurisdiction beyond broker-dealer activities, such as situations in which there are indications of fraud involving potential serious harm to investors. FINRA should more aggressively exercise its authority to investigate member firms and associated persons and to gather evidence as a basis for enforcement action. In the Stanford case, for example, by more aggressively using its authority, FINRA could have obtained evidence of wrongdoing much earlier than it did. FINRA should also amend its by-laws or rules to enable it to obtain information from or investigate affiliates of member firms to enforce such firms' compliance with the Exchange Act and FINRA rules. This authority is particularly important to enable

FINRA to pursue enforcement actions against member firms or registered persons when it believes there is evidence of fraud or potential serious harm to investors. This recommendation will require SEC approval to expand FINRA's jurisdiction.

2. Examination Process and Personnel

A. Focus the Examination Program on Fraud; Establish a Fraud Detection Unit. A core element of FINRA's examination program should be the detection and prevention of fraud. The Special Committee agrees with and supports the plan of FINRA senior management to create a dedicated fraud detection unit. That unit should include highly trained fraud examiners.

B. Prioritize Examinations and Resources According to the Seriousness of Misconduct. FINRA should revise the examination program to assure that examinations are properly prioritized and resources allocated accordingly. In particular, the program should expedite any examination that identifies possible fraud involving potential serious harm to investors or continuing serious misconduct.

C. Strengthen the Cause Examination Program; Revise the Cycle Examination Program. FINRA should strengthen the cause examination program and revise the cycle examination program, shifting resources from low-risk cycle examinations to higher risk cause examinations. If FINRA is to be more effective at protecting investors from fraud and Ponzi schemes, it will need to significantly expand the resources devoted to cause examinations. This will also require strengthening the procedures for evaluating complaints, tips and other information and improving coordination among various FINRA departments responsible for such evaluation. This recommendation requires SEC concurrence to revise the cycle program.

D. Assess Structure and Management of District Offices. FINRA should assess the structure and performance of its district offices to assure that each office is carrying out the

examination program efficiently and effectively. Our review of the Stanford and Madoff cases suggested significant inconsistencies in levels of performance and operational standards in the district offices that we reviewed. In particular, evaluation of the program should emphasize quality of examinations and not focus primarily on the quantity of examinations.

E. Improve Documentation and Tracking of Enforcement Referrals to and from the SEC and Other Authorities. FINRA should improve its process to record and track enforcement referrals to other agencies and those received by FINRA from the SEC or any other regulatory authority.

F. Improve Procedures to Assure Legal and Regulatory Issues Are Properly Escalated, Addressed and Documented. FINRA should revise its procedures for addressing and documenting important legal and regulatory issues that arise in connection with an examination. These include legal issues involving a large amount of funds or having an impact on many members. Such issues, which require legal research and analysis, should be addressed by attorneys, not by examiners or paralegals, and the legal analysis for any significant issue should be documented, reviewed, and approved by a supervising attorney.

G. Increase Use of Examination Staff with Specialized Qualifications. FINRA should make greater use of employees with specialized training (*e.g.*, certified public accountants with public accounting and auditing experience in the securities industry; experienced internal auditors and fraud examiners; traders and trading assistants with extensive experience in and understanding of, among other things, trading markets, derivative products, complex financial instruments and financial statement analysis).

H. Enhance FINRA's Information Technology and Systems. Technological improvements should be made to the principal information technology systems utilized by the

examination staff. The goal should be to make more member firm data readily available to the examination staff, including all significant changes in member firms, regulatory actions, and significant documents. FINRA should also improve examiners' capability to analyze firms' financial data electronically.

I. Confirm Member-Provided Information with Independent Third Parties; Cross-check Data Provided by Member Firms. FINRA should require its examination program to include procedures to test member-provided information against information from independent sources, rather than relying almost exclusively on data from member firms. FINRA also should confirm the consistency of data provided to it by each firm by cross-checking data in various submissions by a firm. FINRA should work with the SEC, and other appropriate regulatory agencies such as the Public Company Accounting Oversight Board, to secure consent from third parties (*e.g.,* independent auditors) to provide means for FINRA to validate data provided by its member firms.

3. Coordination with the SEC and Other Regulatory Agencies

A. Expand Access to and Use of Information from the SEC and Other Agencies. To improve the effectiveness and efficiency of the examination program, and for investor protection reasons, FINRA should have more complete information on other authorities' actions against FINRA member firms and registered persons. FINRA should be provided with greater access to such information that is available from the SEC and other regulatory and law enforcement agencies. FINRA should continue to provide information to other regulatory agencies as appropriate. This recommendation requires concurrence by the SEC and other agencies.

B. *Clarify Policies Regarding Concurrent SEC and FINRA Examinations.* FINRA should revise and standardize its policies to clarify the effect of a concurrent SEC examination or investigation on the scope of a FINRA examination of the same member firm.

4. Training of FINRA Personnel

A. *Enhance FINRA's Current Training Program.* FINRA should implement new continuing education standards, requiring the examination staff to complete a defined number of training programs or hours over a specified period. FINRA should also expand training initiatives focused on fraud detection and investigation techniques.

5. Plan of Action

The Special Committee believes the recommendations above should be implemented by a Plan of Action developed by management and presented for consideration by the Board. Management has agreed to present a Plan of Action for approval or ratification at the December 2009 Board meeting. Execution of the Plan of Action should be monitored by a designated committee of the FINRA Board.

APPENDIX A

2009 FINRA Special Review Committee Charter

Composition
The 2009 FINRA Special Review Committee (Committee) will be composed of four FINRA Board members.

Purpose
The purpose of the Committee will be to review FINRA's examination program, in particular with respect to Ponzi schemes operated by the unregistered affiliates of Madoff Investments and Stanford Financial.

Duties and Responsibilities
The Committee shall have the following duties and responsibilities:

(i) Review and discuss with management the operation of the FINRA examination program, in particular with respect to the Ponzi scheme activities of Madoff Investments and Stanford Financial.

(ii) Recommend to the Board and to management changes in the examination program, where appropriate, to improve FINRA's member oversight and fraud detection capability.

(iii) Review and discuss with management its policies and procedures relating to monitoring compliance with examination program policies.

The Committee shall have the authority to obtain advice and assistance from internal or external legal or other consultants and advisors, and to incur such expenses as the Committee in its discretion determines necessary and appropriate in carrying out the Committee's work.

Approved April 3, 2009; amended April 13, 2009

FINRA Special Review Committee Roster

Committee Members:

- Charles A. Bowsher, Chair
- Ellyn L. Brown
- Harvey J. Goldschmid
- Joel Seligman

Board Advisors to the Committee

- Mari Buechner
- W. Dennis Ferguson
- G. Donald Steel

EXHIBIT 131

RE: Stanford--request to bank

8/17/2005 6:17:25 PM

From: (b)(6), (b)(7)c
To: (b)(6), (b)(7)c @SEC.GOV]
Cc: (b)(6), (b)(7)c @SEC.GOV]; (b)(6), (b)(7)c @SEC.GOV]

(b)(6), (b)(7)c

You will be glad to know that I forwarded (without comment) the latest iteration of the draft letter to (b)(6), (b)(7)c and informed her that you would like to send the letter in the very near future.

Although we had a fulsome discussion over the telephone, I thought it would be helpful to explain our suggestions. It s our experience, for example, that a fuller explanation of our investigations is necessary (and more likely to produce a favorable response) whenever we ask for the voluntary cooperation of a company. I understand your argument (among others) about creating a bad precedent, but a request to an Antiguan bank represents special circumstances, a fact that can be explained to opposing counsel who ask for a similar letter. In addition, it s my personal belief that without a veiled threat such as, Please let us know by August 22, if you do not plan to cooperate so that we may explore other avenues to obtain these records from the Bank there s no impetus to nudge a company to cooperate. I understand your arguments to the contrary, but I would rather lose credibility by not following up with stronger measures (especially when Stanford has no way of knowing whether we can perform) than send a letter that relies on the good will of the recipient.

As this letter may mark the end of your investigation, I think it makes sense that we think long and hard about the type of letter we wish to send.

In conclusion, let me point out that I spent nearly 14 years in Enforcement (HQ) before joining OIA in April of this year. Rest assured that I am very much on your side, that I see matters from an Enforcement (not OIA) perspective. Please take my observations above as coming from a former colleague who s very much on your team.

I will do my best to get (b)(6), (b)(7)c comments (if any) by tomorrow morning. Have a good, rest of the day!

(b)(6), (b)(7)c

-----Original Message-----
From: (b)(6), (b)(7)c
Sent: Wednesday, August 17, 2005 11:20 AM
To: (b)(6), (b)(7)c
Cc:
Subject: Stanford--request to bank

(b)(6), (b)(7)c, Per my earlier voice mail to you, attached is the letter requesting SIB's voluntary assistance. Feel free to give me or (b)(6), (b)(7)c a call if you have any questions or comments.

Thanks,

(b)(6), (b)(7)c

(b)(6), (b)(7)c

Enforcement Attorney

United States Securities and Exchange Commission

801 Cherry Street, Suite 1900

Fort Worth, TX 76102

Direct phone: (b)(6), (b)(7)c

Facsimile: (b)(6), (b)(7)c

(b)(6), (b)(7)c

EXHIBIT 132

RE: Stanford 9/3/2005 5:51:22 PM

From: [redacted]
To: Cohen, Jeffrey A [redacted] @SEC.GOV], [redacted] @SEC.GOV]

Will do. [redacted], please close it. Gracias.
Sent from BlackBerry Wireless Handheld.

-----Original Message----- [redacted]
From: Cohen, Jeffrey A. [redacted] @SEC.GOV>
To: [redacted] @SEC.GOV>; [redacted] @SEC.GOV>
Sent: Sat Sep 03 13:12:32 2005
Subject: RE: Stanford

Close the case.

-----Original Message-----
From: [redacted]
Sent: Thursday, September 01, 2005 1:37 PM
To: Cohen, Jeffrey A.; [redacted]
Subject: Re: Stanford

Antigua will not compel bank to produce docs. After much time talking with OIA, we finally received green light to issue volunary doc request to bank, care of the bank's attorney. Letter issued last week. [redacted] spoke with attorney for bank, who stated bank would not be producing docs. However, attorney is willing to meet with us in an effort to convince us bank's activities are proper.

[redacted]

Let me know what you think.
Sent from BlackBerry Wireless Handheld.

-----Original Message----- [redacted]
From: Cohen, Jeffrey A. [redacted] @SEC.GOV>
To: [redacted] @SEC.GOV) [redacted] @SEC.GOV>; [redacted] @SEC.GOV) [redacted] @SEC.GOV>
Sent: Thu Sep 01 12:50:26 2005
Subject: Stanford

Whatâ€™s the status of OIAâ€™s letter to the Caribbean banking authorities? What is OIA telling you?

EXHIBIT 133

RE: Stanford
From: (b)(6), (b)(7)c
To: (b)(6), (b)(7)c @SEC.GOV]

8/29/2005 9:20:00 AM

bueno

From: (b)(6), (b)(7)c
Sent: Monday, August 29, 2005 8:41 AM
To: (b)(6), (b)(7)c
Subject: FW: Stanford

Fyi. OK, so I'll get the letter out today.

From: (b)(6), (b)(7)c
Sent: Friday, August 26, 2005 12:24 PM
To: (b)(6), (b)(7)c
Cc:
Subject: RE: Stanford

(b)(6), (b)(7)c —

(b)(6), (b)(7)c gave me the thumbs up to tell you that you may send your letter. I have been in contact with the IRS Attache recently, and I hope to get things moving on that end.

(b)(6), (b)(7)c

From: (b)(6), (b)(7)c
Sent: Tuesday, August 23, 2005 5:16 PM
To: (b)(6), (b)(7)c
Cc:
Subject: Stanford

Hi (b)(6), (b)(7)c

I was out Fri & Mon and (b)(6), (b)(7)c is out today, but I wanted to touch base with you on the request to SIB. Tom Sjoblom (former SEC attorney now with Chadbourne & Parke in DC) called me today. He represents both the U.S. broker-dealer and the Antiguan bank. I spoke with him in some detail about the documents we would be requesting of SIB. His client's position is that we do not have jurisdiction over SIB; thus, he made it clear that SIB would not be producing documents on a voluntary basis. I think that moots a lot of our discussion on the wording of the letter. We propose to send him the standard letter in the latest draft form to memorialize our request and to get a written response from him. He indicated that he and representatives of Stanford want to come in and meet with us at some point to discuss the substance of our requests. However, it doesn't look like they will be sending us docs on a voluntary basis. As we now have a U.S. attorney on record representing the bank and his statement that they will not produce voluntarily, we think it just makes sense to go ahead and send the standard request. Agree/disagree/indifferent?

Thanks, (b)(6), (b)(7)c

(b)(6), (b)(7)c
Enforcement Attorney
United States Securities and Exchange Commission
801 Cherry Street, Suite 1900

Fort Worth, TX 76102
Direct phone: (b)(6), (b)(7)c
Facsimile: (b)(6), (b)(7)c
(b)(6), (b)(7)c @sec.gov

EXHIBIT 134

U.S. Securities and Exchange Commission

HAROLD DEGENHARDT, HEAD OF THE SEC'S FORT WORTH OFFICE, TO LEAVE THE COMMISSION

FOR IMMEDIATE RELEASE
2005-116

Washington, D.C., Aug. 15, 2005 - Harold F. Degenhardt, District Administrator of the Securities and Exchange Commission's Fort Worth District Office, has announced that he will leave the Commission in September to become a partner in the Dallas office of the law firm of Fulbright & Jaworski, LLP.

Mr. Degenhardt became the District Administrator of the Fort Worth Office in May 1996. In that role, he has been responsible for the agency's enforcement and examination programs in a four state area of the Southwest. Prior to joining the Commission, he was a partner in Gibson, Dunn & Crutcher's Dallas Office. As a member of its Litigation Department, Mr. Degenhardt specialized in general commercial, securities, antitrust, insurance and product liability litigation. Prior to that, Mr. Degenhardt was a litigation associate from 1973 to 1977 with Mudge, Rose, Guthrie & Alexander in New York City and a litigation partner with Coke & Coke in Dallas, Texas.

Under his leadership, the staff of the Fort Worth Office has achieved an exemplary record of productivity in its program functions, has developed an active investor education program and has forged effective partnering relationships with foreign securities regulators as well as with state securities regulators and other law enforcement agencies. During his tenure, Mr. Degenhardt oversaw the handling of high profile matters involving insider trading, accounting and disclosure fraud, stock manipulation and broker-dealer and investment adviser/investment company violations. The Fort Worth Office also has maintained an aggressive and effective examination program that has resulted in a number of enforcement referrals to the District Office's enforcement staff.

Among the more notable enforcement cases brought by the Fort Worth Office during this period were

In the Matter of Dynegy Inc. -- which involved an action against the company and certain corporate officers and employees for the fraudulent use of special purpose entities in violation of GAAP and pre-arranged "wash sales" or "round-trip" energy transactions;

In the Matter of i2 Technologies, Inc. -- which involved a $1 billion misstatement of software license revenue in violation of GAAP;

In the Matter of Aim Advisors, et al and SEC v. Mutuals.com et. al.

involving market timing and/or late trading;

In the Matter of Fleming Companies -- which involved fraudulent earnings overstatements by this major grocery wholesaler and which also involved actions against certain of its vendors for their role in the fraud;

In the Matter of Royal Dutch Petroleum Company and "Shell" Transport and Trading Company, p.l.c. -- which involved a fraudulent 4.5 billion barrels overstatement of proved hydrocarbon reserves; a $6.6 billion overstatement of the standardized measure of future cash flows and the material misstatement of reserve replacement ratios, which are key performance indicators in the oil and gas industry; and

Report of Investigation Pursuant to 21 (a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions -- this milestone Commission report arose from a Fort Worth case, which resulted in no charges against a company as a result of its model cooperation with the Commission, once the misconduct was discovered.

Linda Thomsen, Director of the SEC's Enforcement Division, stated, "Hal has played a critical role in the success of the Fort Worth Office's enforcement and examination programs over the past several years. Under his leadership and guidance, the Fort Worth Office has initiated a number of important cases that have made our markets safer for investors. I wish Hal continued success in his return to private practice. We will miss him."

In announcing his plans to leave the Commission, Mr. Degenhardt said, "For the last nine years, I have been honored to be part of the U.S. Securities and Exchange Commission's mission and to serve with its highly committed and effective staff of substantive program professionals and support personnel in both the field offices and in the home office. I have never served with such an extraordinary group of dedicated people." Mr. Degenhardt went on to comment, "Any closing remarks would be incomplete without singling out the staff of the Fort Worth Office. The job that they have done and the results they have achieved are unequalled in the Commission. To them I say, 'thank you for your hard work, your dedication and for allowing me to be part of this team.' "

http://www.sec.gov/news/press/2005-116.htm

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EXHIBIT 135

U.S. Securities and Exchange Commission

JAMES CLARKSON NAMED ACTING DISTRICT ADMINISTRATOR OF THE SEC'S FORT WORTH DISTRICT OFFICE

FOR IMMEDIATE RELEASE
2005-123

Washington, D.C., Aug. 31, 2005 - Securities and Exchange Commission Chairman Christopher Cox today announced the appointment of James A. Clarkson as Acting District Administrator of the SEC's Fort Worth District Office. The office conducts examinations and enforcement activities in a four state area of the Southwest (Texas, Oklahoma, Arkansas and Kansas).

Clarkson currently serves as the Director of Regional Office Operations in the Division of Enforcement. He will continue in that position and will split his time between Washington and Fort Worth until a permanent District Administrator is appointed.

Clarkson has previously served as an acting head of other Commission field offices during his tenure as Director of Regional Office Operations, including the SEC's offices in New York and Philadelphia. Prior to his appointment to his present position, he was a counsel to two Commissioners and worked in different positions in the SEC's Divisions of Corporation Finance and Enforcement.

Linda Thomsen, the SEC's Director of Enforcement said, "I am very pleased that Jim has agreed to serve as the Acting District Administrator in our Fort Worth Office. He brings a wealth of leadership experience to this assignment which will be important during this time of transition for the Fort Worth Office."

Lori Richards, the Director of the SEC's Office of Compliance Inspections and Examinations stated, "Together with the examination staff in the Fort Worth Office, I know that Jim will maintain the SEC's effective examination oversight of firms in the Southwest."

Clarkson added, "I look forward to the opportunity to work with the outstanding staff in the Fort Worth Office and to help them continue to build upon the office's tradition of excellence."

Clarkson has been with the Commission for over 30 years and has received the SEC's Distinguished Service Award, a Meritorious Executive Rank Award and, along with other members of the Enforcement Division, the Chairman's Award for Excellence. He earned his undergraduate degree from Princeton University, an MBA from Columbia University and his law degree from the New York University School of Law.

http://www.sec.gov/news/press/2005-123.htm

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Modified: 08/31/2005

EXHIBIT 136

Re: 9/21/2005 2:20:42 PM
From: (b)(6), (b)(7)c
To: Cohen, Jeffrey A. (b)(6), (b)(7)c @sec.gov]

I□m sorry Jeff! I thought he was talking or had already talked to you. It was our office--Julie, Hugh, (b)(6), (b)(7)c and maybe Victoria. Julie said they talked to Clarkson and expressed their frustration with the fact that enforcement didn't want to bring a case (this may have been part of a broader discussion, I don't know). (b)(6), (b)(7)c and I spoke with Julie for over an hour today. (b)(6), (b)(7)c did a great job of kind of diffusing the frustration and narrowing down on what exactly Reg proposes that we should do. I don't think anything has changed since we spoke with you last about the case (certainly none of the facts). Julie had a new angle she wanted to discuss, which was going after them for (b)(5), (b)(7)a (b)(5), (b)(7)a

-----Original Message-----
From: Cohen, Jeffrey A.
Sent: Wednesday, September 21, 2005 11:39 AM
To: (b)(6), (b)(7)c
Subject: Fw:

Please respond (I'm not reaching (b)(6), (b)(7)c Who from reg...and are you talking about our office or DC?

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: Cohen, Jeffrey A. (b)(6), (b)(7)c @SEC.GOV>
To: (b)(6), (b)(7)c @SEC.GOV>
Sent: Wed Sep 21 11:35:28 2005
Subject: Re:

Who from reg? How did you hear it? Where's (b)(6), (b)(7)c

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: (b)(6), (b)(7)c @SEC.GOV>
To: Cohen, Jeffrey A. (b)(6), (b)(7)c @SEC.GOV>
Sent: Wed Sep 21 09:46:10 2005
Subject: RE:

Hi Jeff. I am working on the memo--I'd say I'm about 1/2 done. I should make good progress today. Should have it in good shape by the end of the week. We just officially Wells'd (how do you spell that??) Erickson yesterday. (b)(6), (b)(7)c indicated that he hasn't been able to get his client to budge.

On Stanford, this morning I heard that people from reg met with Clarkson yesterday about it. A little annoying, eh? Do you know anything about that? I'll tell you what I know when I see you.

-----Original Message-----
From: Cohen, Jeffrey A.
Sent: Wednesday, September 21, 2005 7:12 AM
To: (b)(6), (b)(7)c
Subject:

Hi (b)(6), (b)(7)c

Whatjs the status of the Magnum memo?

Sent from my BlackBerry Wireless Handheld

EXHIBIT 137

RE: Stanford Group

9/21/2005 11:35:00 AM

From: (b)(6), (b)(7)c

To: Cohen, Jeffrey A. (b)(6), (b)(7)c @SEC.GOV]

Gave you a buzz. Call me at your convenience (b)(6), (b)(7)c

-----Original Message-----
From: Cohen, Jeffrey A.
Sent: Wednesday, September 21, 2005 10:41 AM
To: (b)(6), (b)(7)c
Subject: Fw: Stanford Group

(b)(6), (b)(7)c

Please call me about this.

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: Preuitt, Julie A. (b)(6), (b)(7)c @SEC.GOV>
To: Clarkson, James < @SEC.GOV>; Addleman, Katherine S. (b)(6), (b)(7)c .@sec.gov>; Cohen, Jeffrey A. (b)(6), (b)(7)c @SEC.GOV> (b)(6), (b)(7)c @SEC.GOV> (b)(6), (b)(7)c @SEC.GOV>
CC: Wright, Hugh M. (b)(6), (b)(7)c I@SEC.GOV>; Prescott, Victoria F. (b)(6), (b)(7)c @SEC.GOV>; (b)(6), (b)(7)c @SEC.GOV>; (b)(6), (b)(7)c @SEC.GOV>

Sent: Wed Sep 21 09:48:50 2005
Subject: Stanford Group

We have completed our report on Stanford. Please see attached.

EXHIBIT 138

Re: 10/24/2005 6:36:00 PM

From: Preuitt, Julie A.
To: Cohen, Jeffrey A. [(b)(6), (b)(7)c @sec.gov]

I appreciate that. I certainly like you too and don't want conflict with you.

This is a really tough nut to crack. I look forward to hearing your ideas.

Julie

U.S. Securities & Exchange Commission
801 Cherry St. Ste. 1800
Fort Worth, TX 76104
(b)(6), (b)(7)c

From: Cohen, Jeffrey A.
Sent: Monday, October 24, 2005 5:25 PM
To: Preuitt, Julie A.
Subject:

You know I like and admire you Julie, and I appreciate and respect your passionate commitment. We'll do everything we can on Stanford until we reach diminishing returns. I've got some ideas.

From: Cohen, Jeffrey A.
Sent: Monday, October 24, 2005 3:53 PM
To: Preuitt, Julie A.
Cc: (b)(6), (b)(7)c; Addleman, Katherine S.
Subject: RE: Stanford

Julie,

Since our last meeting in (b)(6), (b)(7)c office last week, (b)(6), (b)(7)c and I met to discuss with the legal intern (b)(6), (b)(7)c the fruits of her research. (b)(5), (b)(7)a We've been waiting for the research you said Victoria was putting together on the issues we identified at our last meeting. Is that ready for us to review?

From: Preuitt, Julie A.
Sent: Monday, October 24, 2005 3:36 PM
To: Addleman, Katherine S.
Cc: Cohen, Jeffrey A.; (b)(6), (b)(7)c
Subject: FW: Stanford

Can we discuss before closing?

Julie

U.S. Securities & Exchange Commission
801 Cherry St. Ste. 1800
Fort Worth, TX 76104
(b)(6), (b)(7)c

From: (b)(6), (b)(7)c
Sent: Monday, October 24, 2005 3:16 PM
To: Prescott, Victoria F.; Preuitt, Julie A.

Cc: Cohen, Jeffrey A.
Subject: Stanford

Julie and Victoria,
FYI, we have decided to recommend closing the Stanford investigation. We're preparing the closing memo. I'll keep you posted.

--
(b)(6), (b)(7)c

Enforcement Attorney
United States Securities and Exchange Commission
801 Cherry Street, Suite 1900
Fort Worth, TX 76102
Direct phone: (b)(6), (b)(7)c
Facsimile: (b)(6), (b)(7)c
(b)(6), (b)(7)c@sec.gov

EXHIBIT 139

U.S. Securities and Exchange Commission

KATHERINE ADDLEMAN NAMED ASSOCIATE DISTRICT ADMINISTRATOR FOR ENFORCEMENT IN THE SEC'S FORT WORTH DISTRICT OFFICE

FOR IMMEDIATE RELEASE
2005-120

Washington, D.C. Aug. 23, 2005 - The Securities and Exchange Commission today announced the appointment of Katherine S. Addleman as Associate District Administrator for Enforcement in the Commission's Fort Worth District Office. The District Office has jurisdiction over both enforcement and regulatory programs in a four-state area of the Southwest.

Addleman, 44, joins the Fort Worth Office with more than 16 years of experience in the Commission's enforcement program investigating and litigating numerous cases alleging issuer accounting fraud, investment adviser fraud, market manipulation, brokerage firm fraud and supervisory failures, offering fraud and insider trading. She has served as the Associate District Administrator for Enforcement in the Commission's office in Atlanta, Ga., since 2004. Previously, Addleman was an Assistant Regional Director of Enforcement for the Central Regional Office in Denver, Colo., and an Enforcement Branch Chief in the Commission's Fort Worth District Office. She also served as an associate with a Dallas law firm where she specialized in securities litigation. Addleman began her legal career as an enforcement staff attorney and special counsel in the Commission's office in Philadelphia, Pa.

Included among the more significant and high profile enforcement actions she has directed are the following:

- investigation by the Central Regional Office staff of accounting fraud and disclosure violations by Qwest Communications International Inc. which resulted in a series of actions against the company, 22 officers and employees of Qwest, and the engagement partner at Arthur Anderson LLP, Qwest's outside auditors;
- actions against Deloitte & Touche LLP, the engagement partner and the audit manager for audit failures in connection with their audit of the financial statements of Just for Feet, Inc.;
- proceedings against the Coca-Cola Company relating to failures to disclose certain end-of-quarter sales practices used to meet earnings expectations; and
- actions alleging insider trading in cases such as Tyson Foods, Inc and ShowBiz Pizza Time, Inc.

Harold F. Degenhardt, the current District Administrator of the Fort Worth District Office, said, "I am pleased to welcome Kit home to the Southwest and to the Fort Worth Office. She is very capable and experienced and I look to her to continue the extraordinary enforcement accomplishments of this office, both in terms of the quality of its cases and the level of its productivity."

Linda Thomsen, Director of the SEC's Enforcement Division, stated, "Kit has had a distinguished career at the SEC. She has been responsible for a number of major enforcement cases that have had an important impact on our securities markets and have materially enhanced the Commission's efforts to protect investors in these markets. I am confident that she will bring both tremendous energy and experience to this position and to the Fort Worth Office."

Addleman added, "I am delighted to be returning to the Fort Worth Office enforcement program. I am looking forward to associating with such a productive, dynamic and intelligent group of professionals and to carrying on the traditions of excellence they have established. I have had a terrific experience in the Atlanta and Denver Offices and will continue to cherish the relationships I have built and the experiences I have had in those offices."

Addleman received her undergraduate degree from Wake Forest in 1983 and her law degree from Oklahoma City University School of Law in 1986.

http://www.sec.gov/news/press/2005-120.htm

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EXHIBIT 140

RE: Chat With [redacted] and Jeff

10/28/2005 9:17:00 AM

From: Wright, Hugh M.
To: Clarkson, James [redacted]@SEC.GOV]

I am in and virtually any time will be good except for 9:30-10:00 when I have scheduled a meeting. Kit and I are going to meet sometime today to discuss Jeff as well.

In the meantime I have told Julie to basically [redacted] That is my purpose in assuming the point role on the Stanford matter. Hal and Spence were fully aware of Jeff's activities as far as I know but never took any substantive action that I heard of.

-----Original Message-----
From: Clarkson, James
Sent: Thursday, October 27, 2005 4:08 PM
To: Wright, Hugh M.
Subject: Re: Chat With [redacted] and Jeff

Hugh:

My purpose in telling Jeff to prepare the memo on Stanford laying out his views had two purposes.

The first was to allow me to get up to speed on the basis for enforcement's position on the case.

[redacted]

Jim

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: Wright, Hugh M. [redacted]@SEC.GOV>
To: Clarkson, James [redacted]@SEC.GOV>
Sent: Thu Oct 27 14:50:30 2005
Subject: FW: Chat With [redacted] and Jeff

Jim:
Julie came to me to talk about the situation with Jeff before you sent the email below to her. I asked her to forward it to me so I could reply to you and try to clarify the situation as it relates to Julie, Victoria, and maybe [redacted]

Basically, Julie is scared of Jeff's reactions to anything that crosses him. She told me, and I assume that she told you, about

his statements about (b)(6), (b)(7)c and other statements that he apparently made at a lunch with several members of the staff. According to Julie, Victoria is also very concerned (b)(6), (b)(7)c
(b)(6), (b)(7)c

Whether resolving the issues about the Stanford case will alleviate the situation is questionable. I have instructed Julie to prepare the memo that you have requested about Stanford for my signature. I think that any further discussions of the matter need to be made with me representing the BD exam staff. If the decision is made to close Stanford, that is certainly up to Kit and the enforcement staff. I do not know all the details so I will not express any opinion on that. Frankly, I really never expected enforcement to pursue the matter but it is of such magnitude that I felt it had to be referred and at least considered for enforcement action.

The point that I am trying to make clear is that at lease one member of the staff, and maybe more, are personally concerned
(b)(6), (b)(7)c

I don't know what steps should be taken as this is a new area to me.

-----Original Message-----
From: Preuitt, Julie A.
Sent: Thursday, October 27, 2005 1:19 PM
To: Wright, Hugh M.
Subject: FW: Chat With (b)(6), (b)(7)c and Jeff

Julie
U.S. Securities & Exchange Commission
801 Cherry St. Ste. 1800
Fort Worth, TX 76104
(b)(6), (b)(7)c

-----Original Message-----
From: Clarkson, James
Sent: Thursday, October 27, 2005 1:07 PM
To: Preuitt, Julie A.
Subject: Chat With (b)(6), (b)(7)c and Jeff

I had a chance to chat with both (b)(6), (b)(7)c and Jeff separately before I left for the airport. I hope my talk with (b)(6), (b)(7)c helped.

I advised Jeff that I understood that the exam staff and the folks in enforcement were wrestling with how to deal with the Sandford matter. I requested that he prepare for me a brief memo setting out the reasons why enforcement feels that the case can't be made.

I would like you to do the same from an exam staff perspective. I know that you have already prepared a fairly detailed presentation on the results of the inspection your staff conducted. If you could boil that down to a relativly short memo, I would appreciate it.

When I return to the FWDO on November 7th, Kit and I will plan to sit down with you and Jeff and resolve this matter one way or the other.

Thanks.

Jim

Sent from my BlackBerry Wireless Handheld

EXHIBIT 141

RE: (b)(6), (b)(7)c 10/26/2005 10:22:23 AM
From:
To: (b)(6), (b)(7)c @SEC.GOV]

Cool (the house), let me know what happens!
I totally do agree with Jeff. Julie is just really passionate about this and is fighting hard, going to Kit, etc. and so we have to do all this stuff. It's frustrating!

Yes, (b)(6), (b)(7)c closing rec is in DC.

-----Original Message-----
From: (b)(6), (b)(7)c
Sent: Wednesday, October 26, 2005 10:17 AM
To: (b)(6), (b)(7)c
Subject: Re:

Still looking for house. Making offer on one today. We'll see.

On Stanford, agree with Jeff. If no offering fraud, not worth pursuing.

Is (b)(6), (b)(7)c closing rec in DC?
Sent from BlackBerry Wireless Handheld.

-----Original Message-----
From: (b)(6), (b)(7)c @SEC.GOV>
To: (b)(6), (b)(7)c @SEC.GOV>
Sent: Wed Oct 26 11:05:40 2005
Subject: RE:

Hey. Well, Stanford is kind of a goat screw. Long story short, Jeff told me to kill it, Julie was upset, started an email battle, long talks with Julie, fight b/w Julie and Jeff (Julie won), now I'm researching and doing all kinds of stuff on it, but still am (b)(5), (b)(7)a, but having to run down every possible scenario. It's not so much fun. That's about all.

What's up with you? Have you found a house? How's the fam?

-----Original Message-----
From: (b)(6), (b)(7)c
Sent: Wednesday, October 26, 2005 9:51 AM
To: (b)(6), (b)(7)c
Subject:

What up? And developments on your cases?
Sent from BlackBerry Wireless Handheld.

EXHIBIT 142

RE: Chat Witl [redacted] and Jeff

10/27/2005 4:42:00 PM

From: Wright, Hugh M.
To: Addleman, Katherine S. [redacted] @sec.gov]

Either place is ok with me and whenever.

-----Original Message-----
From: Addleman, Katherine S.
Sent: Thursday, October 27, 2005 2:59 PM
To: Wright, Hugh M.
Subject: Re: Chat With [redacted] and Jeff

Thanks Hugh. I was planning on talking with Jim about what issues I know about. I would like to talk to you first. My issues are primarily centered around [redacted]
Let's try to get together in the morning. I will come down unless you would rather talk in my office.

Kit

Sent from Katherine Addleman's BlackBerry Wireless Handheld

-----Original Message---[redacted] @SEC.GOV>
From: Wright, Hugh M.
To: Addleman, Katherine S. [redacted] @sec.gov>
Sent: Thu Oct 27 14:52:57 2005
Subject: FW: Chat With [redacted] and Jeff

Kit: We need to talk about this tomorrow. It is considerably more involved than just relating to whether Stanford should be closed.

-----Original Message-----
From: Preuitt, Julie A.
Sent: Thursday, October 27, 2005 1:19 PM
To: Wright, Hugh M.
Subject: FW: Chat With [redacted] and Jeff

Julie
U.S. Securities & Exchange Commission
801 Cherry St. Ste. 1800
Fort Worth, TX 76104
[redacted]

-----Original Message-----
From: Clarkson, James
Sent: Thursday, October 27, 2005 1:07 PM
To: Preuitt, Julie A.
Subject: Chat With [redacted] and Jeff

I had a chance to chat with both [redacted] and Jeff separately before I left for the airport. I hope my talk with [redacted] helped.

I advised Jeff that I understood that the exam staff and the folks in enforcement were wrestling with how to deal with the Sandford matter. I requested that he prepare for me a brief memo setting out the reasons why enforcement feels that the case can't be made.

I would like you to do the same from an exam staff perspective. I know that you have already prepared a fairly detailed presentation on the results of the inspection your staff conducted. If you could boil that down to a relativly short memo, I would appreciate it.

When I return to the FWDO on November 7th, Kit and I will plan to sit down with you and Jeff and resolve this matter one way or the other.

Thanks.

Jim

Sent from my BlackBerry Wireless Handheld

EXHIBIT 143

MEMORANDUM

TO: Jim Clarkson
Acting District Director

Kit Addleman
Associate Director (Enforcement)

FROM: Hugh Wright
Associate Director (Regulation)

BY: Julie Preuitt
Assistant Director (BD examinations)

SUBJECT: Stanford Group Company

DATE: November 7, 2005

An October 2004 examination of Commission-registered broker-dealer, Stanford Group Company ("Stanford"), headquartered in Houston, Texas uncovered evidence suggesting that Stanford and its affiliate Stanford International Bank ("Stanford Bank") may be violating the securities laws. Most notably, we are concerned that Stanford Bank is using Stanford to disseminate its unregistered securities which appear to be part of a $3 billion fraudulent scheme (possibly money laundering and/or a ponzi scheme).

The security issued by Stanford Bank is marketed as a CD with set terms including investment periods, minimum investment amounts, and minimum interest rates. Unlike customer deposits into a U.S. bank, Stanford Bank claims to invest customer funds in a manner that would subject the customer deposits to loss including investing into both foreign and U.S. equities, debt instruments (including U.S. and foreign government and corporate debt), and foreign currencies and precious metals.

The offering has many earmarks of a fraudulent offering including:

- Stanford Bank will not Disclose its Portfolio: Most troubling of all, Stanford Bank refuses to disclose any of its specific uses of customer funds. Not only will it not give information as to what it currently holds, it refuses to give any specific information as to it its holdings at any point of time. Stanford Bank first claimed that it would not give out that information because of the Antiguan banking secrecy laws. We responded that we thought the bank secrecy laws related to the identity of the depositors rather than the actual use of funds. Stanford Bank then countered that giving us that information would violate the Chinese Walls between itself and Stanford Group. The staff is unaware of any Chinese Walls between Stanford Bank and Stanford Group. Neither does that explain why they wouldn't give the staff the information or why they wouldn't share past portfolio

holdings. The staff is unaware of any legitimate reason as to why Stanford Bank would not disclose its holdings.

- Offering Minimum/Excessive Interest Rates: Since investor funds are supposedly placed at risk, it is illogical to understand how the investment can pay guaranteed minimum returns unless, in times of loss in the portfolio, the source of those returns are paid from some other source than the actual returns on the customers' funds. There is no explanation in any of Stanford Banks materials which would explain how returns can be paid in times of loss. Furthermore, both the guaranteed minimum interest rates and the actual interest rates paid appear to be higher than would be reasonably expected on any investment that markets itself as conservative enough to offer a guaranteed minimum return. SIB paid average interest rates of 9.63% in 2000, 9.13% in 2001, and 7.17% in 2002.

- High Earnings Every Year: Stanford Bank claims that it has consistently been profitable every year over the last ten years. For example, from 2000 through 2002, Stanford Bank reported earnings on investments between approximately 12.4% and 13.3%. Such returns are incredible when you consider that during this same time period, Stanford Bank claimed to have invested at least 40% of its customers' assets into the global equity market. Ten of twelve global equity market indices were down substantially during the same time period. The indices we reviewed were down by an average of 11.05% in 2000, 15.22% in 2001, and 25.87% in 2002. It is unlikely that the remaining portion of the portfolio of investments, which were supposedly mostly invested into debt instruments, generated enough return to make the total return that Stanford Bank claimed. For example, in 2002, when the global indices were down 25%, and if Stanford Bank suffered such losses, the remaining portion of the portfolio not invested into the equity markets would have had to generate an approximate 35 to 40% return for Stanford Group to generate the 12.4% overall return it claimed.

- Growing Rapidly/In a Constant State of Growth: Stanford is expanding rapidly. From what records we can obtain it has increased its assets by approximately 50% over the last 18 to 24 months. Per our discussions with current and former Stanford Group personnel, Stanford Bank has been in a consistent state of growth over the past ten years and the pressure to increase the amount of sales has increased over the last two or three years. Accordingly, Stanford Bank has not had to undergo any period when withdrawals have exceeded deposits. Such pressure to increase sales is frequently associated with fraudulent schemes.

In light of the earmarks of fraud noted above, it is troubling to imagine the Commission failing to resolve its concerns regarding the legitimacy of the product offered because the relevant parties either refuse to or cannot provide the requested, necessary information to confirm or dispel those concerns. Just as troubling, is to imagine the Commission to continue allowing a U.S. registered broker-dealer to offer a product about which it does not have the necessary information to make a reasonable basis for a recommendation.

The examination staff recognizes that investigating Stanford Group and Stanford Bank involves significant hurdles due to the lack of information; however, the examination staff has developed the fact situation as far as possible under our examination authority. Therefore, we believe that a Formal Order of Investigation would significantly enhance the Commission's ability to gain further information about Stanford Group and possibly Stanford Bank's activities.

EXHIBIT 144

Pages 255 through 265 redacted for the following reasons:
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(b)(5), (b)(7)a